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## An Assessment on the Development of Agricultural Initiatives for USAID/CAR

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Central Asia Agricultural Assessment  
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### **Kyrgyzstan**

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## EXECUTIVE SUMMARY

Kyrgyzstan is a small mountainous country with a predominantly agricultural economy. The 2001 Human Development Index (HDI) ranks Kyrgyzstan 92<sup>nd</sup> out of 162 countries. Kyrgyzstan has been one of the most progressive countries of the former Soviet Union in carrying out market reforms. Cotton, wool, and meat are the main agricultural products and exports; industrial exports include gold, mercury, uranium, and hydropower.

The agricultural sector is the main economic sector of the Kyrgyz economy in terms of its contributions to gross domestic product (45 percent), employment (40 percent), and exports (30 percent). Development of the sector is a major government priority, as agriculture is expected to continue to lead the recovery and future growth of the economy. The transition from central planning to privatization of collective and state farms and processing enterprises has led to the dislocation of elements of the agricultural production, processing, and marketing system.

Agricultural exports consistently exceed imports, with exports mainly to the Commonwealth of Independent States. But exports of processed foodstuffs declined severely from \$127 million in 1996 to just \$11.8 million in 2000. Foodstuff imports have exceeded exports since 1999. Domestic food-processing industries have not seen major reinvestments and obsolete processing facilities are unable to meet market demands or have ceased to operate. The emergence of new food-processing industries has been limited.

The Asian Development Bank has recently noted that the poverty level in rural areas is still very high and the reduction in poverty is hindered by serious problems in the agricultural sector. The level of support services in the republic for rural producers is insufficient and the share of financing provided from the national budget to agriculture is decreasing every year. The national system that facilitated the agricultural production cycle has been significantly degraded, from production of agricultural produce to processing and further sales.

Following independence, the government embarked on a massive and comprehensive reform program to transform the country into a market economy. Privatization of state-owned enterprises began in 1991. Massive legislative reforms started in 1992 and resulted in a legal regime supporting private enterprise as the primary growth engine of the economy. The Kyrgyz Republic borrowed heavily to finance its economic transformation without the economic growth to support the debt service. The Russian financial crisis in 1998 and the accumulation of government guaranteed debt for former state-owned enterprises also contributed to the mounting foreign debt. Government foreign debt rose from 36 percent of GDP in 1995, to 51 percent in 1997, and to 94 by 2001. This is the highest external debt to GDP of any Central Asian Republic.

The IMF has taken a strong interest in institutional and economic policy reforms to accelerate the Kyrgyz economic transition to a market economy. Despite the significant reforms undertaken by the Kyrgyz Republic of the last decade, many remain. The Kyrgyz judiciary remains technically weak and reportedly permeated with rent-seeking to effect judicial decisions. Impartial enforcement of commercial law in the newly established economic courts system is lacking.

As a WTO member since 1998, the Kyrgyz Republic continues to work on harmonizing its trade regime, laws and regulations that impact trade in conjunction with the signed protocols and bilateral agreements that enabled the country's accession to the WTO. Many of these legislative, administrative, and regulatory reforms affect the agricultural sector. The Soviet era GOST system of standards, for example, need substantial reforms to meet international standard for trading in goods, particularly commodities and food products. The Kyrgyz government knows and understands what has to be done but the lack of sufficiently educated and trained personnel with the capacity to develop and implement the regulatory and administrative reforms are lacking.

Following independence, the Kyrgyz Republic continued financing agriculture under the Soviet era system until appropriate reforms could be undertaken. Until mid-1994, only the state-owned Agroprombank financed agriculture and the rural sector of Kyrgyzstan with subsidized financing rates and terms. Commercial banks are free to lend to the sector but very few agribusiness or agricultural producers are bankable. In addition, the banks' institutional capacity and the financial legal infrastructure are not sufficiently developed to finance agricultural loans safely.

Kyrgyz agriculture is diverse. Out of a total of 10 million hectares of agricultural land, there are 1.5 million hectares of arable land in lowlands under intensive production, and 8.5 million hectares of upland grasslands and pastures under extensive livestock grazing. There has been an increase in domestic vegetable production due to the increased demand from the neighbouring states primarily Kazakhstan and Eastern Russia (Siberia) which take 97 percent of all Kyrgyz fruit and vegetable exports. Kyrgyzstan has exported significant quantities of onions and tomatoes to Siberia. The increase in demand has stalled since the August 1998 Russian economic crisis.

Rising vegetable production is a direct result of the break-up of state farms and small private farmers entering into the cultivation of what is considered a more profitable crop. It is less regulated than grains and not such a drain on the farmer's financial resources as fruit. Potato production has also increased over the last four years.

The number of the vegetable processing enterprises is about 12 percent of 590 enterprises of the food industry (about 35 plants and 18 mini-processing plants), registered in the statistical committee of the Republic. At present the number of actually operating enterprises is not more than 25. At most enterprises the workshops for production of tinned products don't work but the equipment is operable.

Because most arable lands are irrigated, further productivity gains may be difficult to achieve as the conditions of the irrigation systems have deteriorated due to lack of maintenance. Efficiency of irrigation water use remains a major issue. Irrigation is the most important water use, using almost 90 percent of water resources. Kyrgyz Republic is well endowed with water resources but the balance between available water and the potentially irrigable area varies tremendously between different catchments and different *oblasts*, causing local deficits of water and lower crop yields. Water is mainly diverted from the rivers (Talas, Chui, Naryn and Kara Darya), some of which are partially regulated by reservoirs.

## General integrated agriculture and water resource development model

The consultants recommend that USAID consider designing an integrated agriculture and water resource development activity adapted to local conditions within Kyrgyzstan. We use the term integrated from two perspectives: 1) the integration of value-chain participants (production, processing, marketing, allied industries, and market intermediaries) into a systems approach; and 2) the integration of mutually beneficial donor funded activities into a targeted geographic area to capture potential synergies among existing donor projects.

Within a geographic area the integrated approach would focus existing resources in pilot hydrographic units based on proximity to existing donor resources. This activity would also focus on agro-industries in the water unit such as a fruit and vegetable or cotton industry. Why target enterprises within a hydrographic unit? There are a number of reasons, notably, enterprises in a hydrographic unit: 1) share similar agro-climatic conditions, 2) are part of a common and structured community, 3) share similar constraints and opportunities for growth, 4) have a common enabling/regulatory environment, 5) can provide a more effective water management approach, and 6) enhance the ability to foster necessary cooperation and trust.

The rationale for an integrated approach is based on the need to: 1) facilitate transition from Soviet planned agriculture to market-oriented system, 2) focus on land issues because many agricultural development issues revolve around land rights, ownership, use, including the ability to buy sell and mortgage land, 3) mediate, if not resolve, land tenure and water management issues, 4) recognize sustainable agricultural development including production, processing, finance, and marketing activities, and 5) create synergies among donor projects by focusing diversified resources on common problems.

The primary goal of this approach would be to demonstrate to the GOK how to achieve sustainable growth, through increased efficiency, in agricultural production, processing, and marketing enterprises and the networks in which they operate. Secondary to this goal, the approach will help: 1) reduce poverty, 2) manage natural resources, 3) contribute to national food security objectives, 4) ensure increased revenues for agricultural producers and rural citizens, and 5) build private/public partnerships, sustainable enterprise, and linkages among participating beneficiaries. These goals are consistent with government strategies and thus their willingness to support targeted pilot programs.

### Critical issues

The primary criteria for the selection of a targeted geographic area (hydrographic unit), is the presence of significant donor activity. Implement where resources are available and strive to create synergies among existing projects.

*Caution.* The consultants are not suggesting that USAID and other donor projects integrate their entire work plans to focus on this single geographic or hydrographic unit. We recognize that that would be impractical, if not impossible. What we are suggesting, however, is that the individual projects can dedicate a small portion of their expertise and resources to collaborate in the development of the integrated approach in the target area. For example, in the case of Kyrgyzstan, the LARC project has 18 offices in Kyrgyzstan, so let us suggest that they locate

one office in the target area. Likewise, GTZ conducts agronomic training for farmers throughout Osh and other regions. They will be requested to implement a number of their well developed training modules in the target area. Also, IFDC can implement one demonstration field; MASHAV can implement one drip irrigation activity, etc. The consultants believe that limited, agreed upon, and targeted collaboration is possible within a defined geographic area and will produce the synergies expected to the mutual benefit of all participants.

*Coordination and management.* To be effective, USAID should designate a senior coordinator—a “czar”—to manage the recommended integrated activity. The “czar” should: 1) have extensive business development experience, 2) be able to work independently from any one project, 3) be mandated to liaise with projects, donors and officials, 4) be responsible for developing donor project “integration strategy,” 5) have the authority to negotiate individual MOUs with all pertinent projects, 6) be responsible for monitoring and evaluating impact, 7) facilitate inter-country linkages, 8) be tasked with the collection donor project data on needed policy reform that can be used to foster agro-industrial growth, and 9) be responsible for the dissemination policy reform data and memoranda to interested trade associations and business groups who are able to advocate for policy reform.

## Approach

The Integrated Agriculture and Water Resource Development Activity could be organized into the following four components that correspond with the components of existing donor projects, such as the EDP project:

- A: Agro-industry Strategy Development and Policy Reform
- B: Association and/or member organization development
- C: Business Advisory Services
- D: Business and Market Linkages

## **Component A: Agro-industry Strategy Development and Policy Reform**

This component would respond to two important needs: 1) agro-industries lack comprehensive strategies for their own development, and 2) agro-industry entrepreneurs can and should lead policy reform efforts.

- **Agro-industry strategy development:** The objective of an agro-industry strategy development would be to bring entrepreneurs together in order to develop agro-industry strategies, where strategies define objectives, constraints, and resource requirements and inform specific action plans. These strategies would be used to orient TA to focus on opportunities and constraint mitigation.
- **Policy reform:** The objective of the policy reform activity would be to condition the enabling environment in which these enterprises operate. This would be accomplished by: identifying and prioritizing policy constraints throughout value chain (coordinate information sharing); utilizing agro-industry council’s local

knowledge and influence to promote policy reform; and by collaborating with associations and NGO's to advocate for reform.

### **Component B: Association and/or Member Organization Development**

The objective of an association development component would be to encourage entrepreneurs to form effective member organizations in order to collaborate on 1) joint procurement and marketing mechanisms, 2) organized information diffusion, 3) recurrent training and capacity building, and 4) increase the market orientation of members and democratic processes.

There are different legal forms of member organizations and consideration should be given, depending on resources available in the targeted area. The fundamental question is to focus on a traditional association model or a corporate structure such as the IFC model.

### **Component C: Business Advisory Services**

The objective of the business advisory services is to increase business capabilities of producers, processors, and market intermediaries. The following needs have been identified for each of these three groups:

- Producers (land users) have limited or no agronomic or animal husbandry education, resource management training, market knowledge, or business skills
- Processors are reliant on old technologies and methods, are not market-oriented, unable to access credit, and they often collude with government
- Market intermediaries provide limited services.

### **Component D: Business and Market Linkages**

The objective of the business and market linkages component is to facilitate linkages among participants in the agroindustry value chain, such as producer-processor linkages, finance linkages, market linkages, and public-private linkages.

The objective of the finance linkages task would be to facilitate financial linkages between borrowers and creditors, in that there is a need to provide a menu of financial options depending on country's formal financial climate.

### **Recommendations for Kyrgyzstan**

#### **Recommendation 1: Osh - Integrated agriculture and water resource development activity**

Implementing the integrated approach described above in Osh should be a high priority for USAID because of the direct benefits to Kyrgyzstan as well as benefits for any regional initiatives in the Fergana Valley.

There are a number of interrelated critical issues that need to be considered if USAID undertakes project design work for the Osh Region of Kyrgyzstan that center around the ability of producer-processor-market intermediaries to develop mutually beneficial business relationships. Producers have extremely limited access to seasonal working capital that constrains their production capacity and efficiency. Processors are constrained by a shortage of working capital which further constrains their ability to offer producers/suppliers reliable production contracts. These constraints are further compounded by late payment schemes offered by purchasers of finished products. Markets are underdeveloped and the skills required to develop existing markets are not present to any degree.

There is a terrific opportunity in Osh to create the kind of synergies among donor projects that is required for sustainable agricultural development. Existing donor projects are working on producer, processor, marketing, allied industry, and support institution activities that together, if focused on a target geographic area, could provide the type of development model the government of Kyrgyzstan is looking for in their pursuit of poverty reduction.

### **Recommendation 2: Application of the IFC farmer ownership model**

The consultants were impressed with the IFC Farmer Ownership Model's attempts to resolve constraints on agricultural production, processing, and marketing for its membership. Utilizing an organization for the provision of technical assistance to improve production efficiency, resolve linkages with processors, and support marketing initiatives for its members is a fine example of an integrated approach to agricultural development. We note that although organization currently focuses on cotton production, processing, and marketing, it is also involved in the fruit and vegetable industry.

### **Recommendation 3: Kyrgyz commercial bank training for agricultural sector**

Develop program for training commercial bank officers, including: 1) Agricultural production credit and agro-industrial and food processing cash flow and credit analysis training for commercial bank officers of banks interested in learning how to finance the sector or improve their performance; 2) Work with bankers and processors to develop a working capital financing formula that gives processors needed financing and bankers secure comfort of repayment or collection upon default, 3) Work with bankers to develop appropriate loan pricing programs that meet their profit and revenue targets; have comfortable gross and net interest rate margins; and reflect the reasonable cash flows that agricultural sector borrowers can generate.

Develop borrower training to improve the quality of their business presentations to bankers and their understanding of what banks will and will not do in financing a borrower's operations. For example:

- Borrower training of promising agroindustrial businesses (food processors, wholesalers, processing and marketing associations of producers)
- Technical assistance in seeking nonbank credit for agricultural production—supplier credit, processor credit, trade credit



- Promotion of quality agro-industrial, food processor, and agricultural association borrowers to banks for seeking financing
- Meeting with banks to learn of their interest in financing the sector
- Learning of banks' capabilities, rates and fee structures, business plan and information requirement
- Assisting borrowers in preparing business plan financial projections, including loan servicing costs in accordance with average bank rates and fees.

Government, donor, and business officials have strongly commented on the limited knowledge of bank management and loan officers on the underlying economics of agro-industrial, food processing, and agricultural production. Because the agricultural sector is a high volume, low margin business with substantial internal and external risks, lending to the agricultural sector requires substantial understanding of the business, the people involved, the product cycles of different commodities, and historical markets and market trends.

Agricultural bank training program for loan officers and borrowers can present many opportunities for lender and borrower to learn about the other and develop the type of long term bank/borrower relationship critical to quality commercial agricultural production and processing.

#### **Recommendation 4: Kyrgyz Agricultural Finance Corporation (KFC)**

The Kyrgyz government should be encouraged to set a date to privatize KFC as soon as possible to end any banking market perception that the government is going to finance agriculture and the rural areas. KFC should be prepared for privatization, inviting local, regional, and international parties to find a strategic investor interested in developing the market that KFC has established as its target market. Strategic investors should be committed to maintaining this target market as the central focus.

KFC is receiving technical assistance for its banking organization, lending and administrative operations from TACIS and perhaps these groups will continue even to assist in the development and implementation of a privatization plan. The World Bank and ADB funding of the KFC loan portfolio has been conditioned on the eventual privatization of KFC, but a definitive date and plan have not been developed. USAID should consider providing technical assistance for this activity.

It is not clear to the consultants if TACIS or World Bank are planning privatization prior to the termination of the technical assistance but this should occur to avoid KFC from becoming a government financing program. Clear government commitment should be obtained prior to developing terms of reference or task order.

Steps would include: 1) Development of a bank privatization plan and schedule, including the type of tender to interested investors; 2) Conducting a thorough audit and valuation in

accordance with IAS; 3) Development of appropriate solicitation notices and information packages regarding privatization; 4) Allowance of serious bidders to examine the institution and portfolio; 5) Negotiation with potential bidders regarding each bidder's proposal on its interest in developing the Kyrgyz market and its commitment regarding investment, management, and advisory expertise; 6) Selection of bidder and closing of privatization transaction.

### **Recommendation 5: Introduce a USDA type mediation service**

USDA has an established mediation program for providing mediation services, training of mediators, and trainers of trainers to develop a cadre of professionals to serve rural mediation needs. These services cover the complexities of USDA, EPA and other government policies, regulations, permits, licenses, and regulatory control, such as government agricultural loan programs, water user association disputes. For example, USDA mediators have successfully mediated very complex water management issues, such as mediation in Arizona where several parties were in dispute over water management including Indian nations; state, city, county and town governments, federal and state water project authorities, major agricultural users, and industrial users of water.

### **Recommendation 6: Kyrgyz economic policy—Investors' Secretariat**

A function of the Integrated Agribusiness Project czar should be to gather information on needed economic reforms from all project sources in the Osh Initiative and present them to the Investors' Secretariat. The USAID representative or the Osh czar should be a member of the Secretariat to participate in the economic policy reform messages conveyed to the President.

Tasks would include collecting all USAID and other donor project reform information and transmitting the information to the Secretariat. This would demonstrate strong commitment by USAID to needed economic reforms to improve the Kyrgyz business climate. USAID would utilize this existing and valuable data to back up its reform arguments to the government and the Secretariat would provide a forum for these issues to be heard at the highest levels. It is recognized that actual reform adoption and implementation must occur from the Office of the President; however, this type of centralized information support from USAID and other donors provides a more comprehensive view on economic and business reforms.

### **Regional issues**

The consultants recommend that USAID consider the potential benefits of developing a Ferghana Valley approach that further integrates Kyrgyz (Osh), Uzbek (Ferghana), and Tajik (Khujand/Isfara) activities.

The EDP offices in Osh, Ferghana, and Khujand offer a unique opportunity to advocate enhanced regional trade. EDP has already implemented joint tri-country trade workshops focused on increased trade amongst the three countries. These initiatives should be enhanced with participation with other donor projects to create desired synergies. The proposed Fergana Valley seal of quality is an example of the type of regional initiative that could facilitate regional trade and further market integration.

## TERMINOLOGY AND ACRONYMS

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### TERMINOLOGY

<i>Dekhan</i>	Small private farms of 3 to 5 hectares resulting from the privatization of state ( <i>sovkhozes</i> ) and collective ( <i>kolkhozes</i> ) farms
<i>Hukumat</i>	<i>Raion</i> governmental unit
<i>Hakim</i>	Local district administrator
<i>Kolkhoz</i>	Cooperative farm created during Soviet times
<i>Oblast</i>	Regional administrative unit
<i>Raion</i>	Sub-oblast unit
<i>Raivodhoz</i>	District water management unit
<i>Shirkats</i>	“Privatized” <i>kolkhoz</i> or cooperative farms
<i>Som</i>	Currency of Kyrgyzstan
<i>Sovkhoz</i>	State farm created in Soviet times.

### ACRONYMS

ABA	American Bar Association
ADB	Asian Development Bank
ASSP	Agricultural Support Service Project
BIS	Bank for International Settlements
CAIP	Community Assistance Investment Program
CAMEL	Capital, Assets Management, Earnings, Liquidity
CAR	Central Asian Republic
CEELI	Central and Eastern European Law Institute
CIDA	Canadian International Development Association
CIS	Commonwealth of Independent States
CPC	Crop Protection Chemicals
DSS	Demand, supply and services
DWR	Department of Water Resources
EBRD	European Bank for Reconstruction and Development
EF	Enterprise and Finance
EW	Energy and Water
FINCA	Foundation for International Community Assistance
FSU	Former Soviet Union
FTF	Farmer to Farmer
FY	Fiscal Year
GOK	Government of Kyrgyzstan
GDP	Gross Domestic Product
GTZ	German Society for Technical Assistance
HA	Hectare
HIPC	Highly Indebted Poor Country
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
ICWC	Interstate Commission for Water Coordination

I/D	Irrigation and Drainage
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IMT	Irrigation Management Transfer
KAMIS	Kyrgyz Agriculture Market Information System
KSAP	Kyrgyz Swiss Agricultural Project
KFC	Kyrgyz Agricultural Finance Corporation
MT	Metric Tons
MFI	Microfinance Institution
MOAWR	Ministry of Agriculture and Water Resources
NBKR	National Bank of Kyrgyzstan
NGO	Nongovernmental organization
NPRS	National Poverty Reduction Strategy
OBD	<i>Oblast</i> Basin Department
PCI	Peace Community Initiative
PIU	Project Implementation Unit
RAS	Rural Advisory Services
RES	Rural Enterprise Support
SEAF	Small Enterprise Assistance Fund
SDC	Swiss Development Corporation
SSC	Savings and Settlement Corporation
SME	Small and Medium scale Enterprises
SOE	State-owned enterprise
SPS	Sanitary and phyto-sanitary
TACIS	Technical Assistance Commonwealth of Independent States
TBT	Technical barriers to trade
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VAT	Value Added Tax
WB	World Bank
WUA	Water Users Association
WTO	World Trade organization

## SECTION A

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### Overview

USAID/CAR provides assistance to the agricultural sector in the Central Asian Republics primarily in the areas of water management and agribusiness development. Management of this assistance is the responsibility of the office of Energy and Water (EW) for water, and the office of Enterprise and Finance (EF) for agri-business. USAID/CAR has commissioned this assessment of agricultural activities, including water resources, in order to expand and/or strengthen the Mission's assistance to the sector in selected areas.

#### A1. Task Order Objectives

The overall objective of this task order is to help the Mission determine the nature and scope of additional needed agricultural sector activities. The consultants were asked to look at many aspects of the sector, including production, policies, institutions, and agribusiness development and to identify salient trends that will effect future developments.

The goal of the activity is to determine the critical issues for an effective agricultural assistance program that builds on the strengths of existing programs and falls within the Mission's strategic plan.

The specific tasks of the scope of work include:

- An overall assessment of the agricultural sector in four CAR countries
- An examination of the programs of: (a) other donors, (b) USAID related activities, and (c) International Finance Institutions (IFIs)
- Recommendations for new assistance activities that address critical issues to better enable the offices of EW and EF to reach their Strategic Objectives.

Added to the scope of work during the mission:

- The assessment team should provide, in as much detail as possible, recommendations that the team believes necessary to advance agricultural development relative to, but not necessarily limited to, agricultural policy reform, land reform, agricultural market reform, agricultural credit, agricultural inputs, increased local organizational development and autonomy within the agricultural sector, Water User Associations (WUAs) and farm level water management.
- These detailed recommendations do not necessarily have to be within the context of the current USAID program; rather, they should reflect what the assessment team believes necessary to promote a more efficient and effective agricultural development program.

## **A2. Perspectives and Methodology**

The consultants' approach to assessing agriculture and water has been driven by the need to focus on development of the private sector and management of water resources. The nature of private sector development is a strong indicator of the trends in agriculture and water and the constraints limiting growth in agriculture and responsible water resource management. We have made no assessment of the country's macroeconomic conditions, inflation, or currency stability; we only report on other assessments to provide context.

This assessment is not meant to be comprehensive. Some agriculture and water sub-sectors are not mentioned, as they may not have a major impact on current growth trends. Our focus and perspective draws heavily on past experiences in transitional economies in recognition of the stages or phases that transitional economies normally experience.

The consultants spent very little time in each country for this assessment. Obtaining concrete, factual information and data when the economy or government is in flux is difficult. Accordingly, the nature of the assignment and the time permitted required the consultants to develop a composite assessment based on documents, interviews, and professional judgments made in synthesizing complex and sometimes conflicting information and data. This report reflects the consultants' best collective professional judgment in providing USAID as clear and current a picture as possible on agriculture and water in Kazakhstan, Kyrgyzstan, Uzbekistan, and Tajikistan.

## **A3. Documents Used in This Report:**

1. MAWR, Policy Support Project, 2002, Qualitative Assessment of Land and Agrarian Reform.
2. World Bank/IMF, 2001, National Poverty Reduction Strategy, Comprehensive Development Framework of the Kyrgyz Republic to 2010.
3. Directorate of Random Reviews, 2002 Kyrgyz Republic Food Security Information Bulletin No. 19.
4. FAO, 2003, Economic Incentives and Comparative Advantage of Agricultural Production in Kyrgyz Republic.
5. World Bank, 2000, On-farm Irrigation Project – Project Appraisal Document
6. Asian Development Bank, 1999, Agricultural Area Development Project, Report and Recommendations.
7. Asian Development Bank, 2000, Technical Assistance for Capacity Building in the Ministry of Agriculture and Water Resources.
8. Asian Development Bank, 2002, Agricultural Sector Program, Performance Audit.

9. A.R. Khan, 2002, Growth in the Kyrgyz Republic since mid 1990s: Sustainable development or Agriculture Involution?
10. IMF, 2003, Financial Systems Stability Assessment
11. Helvetas, 2002, Review of the Kyrgyz Republic Agro-processing Industries.

## Section B. Task Order Components

### B1. Examination of the agricultural sector in Kyrgyzstan

#### Kyrgyzstan economy

Kyrgyzstan is a small, mountainous country with a predominantly agricultural economy. The 2001 Human Development Index (HDI) ranks Kyrgyzstan 92<sup>nd</sup> out of 162 countries. The HDI measures a country's achievements in terms of life expectancy, education, and adjusted real income. Cotton, wool, and meat are the main agricultural products and exports. Industrial exports include gold, mercury, uranium, and hydropower.

In the first five years after independence, Kyrgyzstan's economy made more progress in market-oriented reform legislation but less progress in economic growth than the other four Central Asian states. This disparity was largely because Kyrgyzstan lacked the diversified natural resources and processing infrastructure that enable a national economy to survive the shutdown of some sectors by shifting labor and other inputs to new areas of production.

In the late 1980s and early 1990s, industry accounted for only about one-third of the country's economy and less than one-fifth of the labor force. Agriculture remained the primary emphasis on the economy through the 1990s and officially employed over one-third of the labor force. As in other Soviet republics, the vast majority of workers were employed by the state, while most of the remainder worked on private agricultural plots.

The economic system of Kyrgyzstan is undergoing a slow, painful, and uncertain transition. For example, the Kyrgyz Republic's household survey data collected as part of the development of the National Poverty Reduction Strategy (NPRS) with the IMF and World Bank found that in 1999 the incidence of poverty increased to 55.34 percent of the population, with over 23 percent of population in extreme poverty. Since then there has been some reduction in the poverty level, largely the result of economic and social measures taken by the state in order to raise living standards. In the year 2000, poverty declined to 52 percent, while extreme poverty went down to 17.8 percent. In 2001, 47.6 percent of the population was classified as poor and 13.5 percent as extremely poor.

The agricultural sector is the main economic sector of the Kyrgyz economy in terms of its contributions to gross domestic product (45 percent), employment (40 percent), and exports (30 percent). Development of the sector is a major government priority, as agriculture is expected to continue to lead the recovery and future growth of the economy. The transition from central planning to a market economy requires institutional, industry, enterprise, and individual attitudinal changes. The privatization of collective and state farms and processing enterprises has led to the dislocation of elements of the agricultural production, processing, and marketing system. Many collective farms have been converted into family farms that lack access to inputs, knowledge and markets, and survive on subsistence farming. Sustainable linkages between farmers, processors, and consumers have been seriously disrupted over the last ten years. This situation has led to a decrease in the volume and quality of products produced and processed. In many ways, farming is a new profession in Kyrgyzstan and attitudinal change towards entrepreneurship and a market economic is slowly emerging.



## **B1a. Agricultural sector overview**

The main agricultural regions are in the Fergana Valley (Osh and Jalal-Abad provinces), in the northern Chui and Talas valleys, and in the Ysyk-Köl basin in the northeast. Based on National Statistics Committee data, crop productivity levels have improved since 1995, regaining and in some cases surpassing pre-independence levels, with average yields in 2001 for all grains reaching 2.8 t/ha, 2.5 t/ha for wheat, 2.6 t/ha for cotton, and 15.7 t/ha for potatoes. These yield levels are still very poor relative to western yields. The January 2003 Food Security Information Bulletin reports a 0.5 percent decrease in GDP in 2002; however, gross output of agricultural products increased by 3.3 percent over 2001.

Since most arable lands are irrigated, further productivity gains may be difficult to achieve because the irrigation systems have deteriorated due to lack of maintenance. Efficiency of irrigation water use remains a major issue. Efforts to improve the operation and maintenance of the irrigation systems continue, and reinvestments for rehabilitation have commenced with assistance from ADB and the World Bank.

Agricultural exports fluctuated from \$45.2 million in 1997 to \$56.8 million in 1999 to \$46.9 million in 2000, rising to \$59.3 million in 2001, and about \$46.8 million in 2002. Cotton, textiles, leather, and fruit and vegetables are the major export products. Agricultural imports rose from \$17.0 million in 1995 to \$31.4 million in 1999 and \$40.9 million in 2000, and declined sharply to \$15.9 million in 2001 and about \$20 million in 2002. Agricultural exports consistently exceed imports, with exports mainly to the Commonwealth of Independent States. But exports of processed foodstuffs declined severely from \$127 million in 1996 to just \$11.8 million in 2000. Foodstuff imports have exceeded exports since 1999. Domestic food-processing industries have not seen major reinvestments and obsolete processing facilities are unable to meet market demands or have ceased to operate. The emergence of new food-processing industries has been limited.

Notwithstanding the results reportedly achieved, the Asian Development Bank has recently noted that the agricultural sector has not provided a sufficient increase in the income of the rural population. The high poverty level in rural areas is exacerbated by serious problems in the agricultural sector and an insufficient level of support services for rural producers. The share of the national budget for financing agriculture is decreasing every year. In terms of economic performance the agricultural sector and processing industry operate under different conditions. This engenders a lack of cooperation among them and, as a result, overproduction of agricultural produce has become more frequent. The national system that facilitated the whole agricultural cycle has been significantly degraded, starting with production of agricultural produce and ending with its processing and further sales. Export of agricultural raw materials is impeded by high costs of access to external markets. All these factors have resulted in a weakness in the incomes of rural workers and problems in supplying processing industry with raw materials.

This ADB report also notes that any further development of agricultural production will largely depend upon increases in the level of irrigated farming, irrigation network development, and improvement of irrigation methods. Development of livestock breeding will be focused on meat and milk production to attain production volumes satisfying not only the local market, but

sufficient for partial selling of these products on external markets. To ensure growth of agricultural production, it is also necessary to improve the activities of agricultural support services. For this purpose measures will be taken to establish agro-chemical and agro-technical services in each village government. Special attention will be paid to the economic and social infrastructure in rural areas: rehabilitation of roads and communications, improved access to healthcare and educational services, and safe potable water for rural inhabitants.

## **B1b. Government policies and programs**

### **Government Economic and Agricultural policy environment**

#### **A. General GOU Macroeconomic Policies**

The Kyrgyz Republic is one of the more liberalized of the former Soviet republics. Following independence, the government embarked on a massive and comprehensive program to transform the country into a market economy. Privatization of state-owned enterprises began in 1991 were completed within a couple of years. Massive legislative reforms started in 1992 and resulted in a legal regime supporting private enterprise as the primary growth engine of the economy.

Enormous foreign debt overshadows the economy. The Kyrgyz Republic borrowed heavily to finance its economic transformation without the economic growth to support the debt service. The Russian financial crisis in 1998 and the accumulation of government-guaranteed debt for former state-owned enterprises also contributed to the mounting foreign debt. Government foreign debt rose from 36 percent of GDP in 1995, to 51 percent in 1997, and to 94 by 2001. This is the highest external debt to GDP ratio of any Central Asian Republic. The government is well aware of the seriousness of its external debt and has strengthened its institutional framework with the Law on Public and Non-Public Debt. Tight monetary and fiscal policies, better revenue collection, and restrictions on public expenditures have improved the government's finances. Restructuring of the country's debt with the Paris Club in 2002 and a three year Poverty Reduction Grant Facility with the IMF have also improved the country's fiscal picture. This grim picture does mean that the government has fewer resources to subsidize the agricultural sector.

Despite the significant reforms undertaken by the Kyrgyz Republic in the last decade, many problems remain. The Kyrgyz judiciary remains technically weak and reportedly permeated with rent-seeking officials, and enforcement of commercial law in the newly established economic courts system lacks impartiality.

#### **B. GOU Agricultural Sector Management**

As a WTO member since 1998, the Kyrgyz Republic continues to work on harmonizing its trade regime, laws, and regulations to the signed protocols and bilateral agreements that enabled the country's accession to the WTO. Many of these legislative, administrative, and regulatory reforms affect the agricultural sector. The Soviet era system of standards, for example, needs substantial reforms to meet international standards for trading in goods, particularly commodities and food products. Meat inspection, packaging and labeling, import and export certificates of seed, crop protection chemicals (CPCs), and food products of all kinds must be reformed to meet international standards. The Kyrgyz government knows and understands what has to be done but

lacks sufficiently educated and trained personnel with the capacity to develop and implement the regulatory and administrative reforms.

Like its neighboring countries, the Kyrgyz Republic has largely adopted an economic policy of developing local agricultural production as a matter of food security as well as a way to reduce imports and increase foreign exchange. The government understands that it has limited financial resources or borrowing power to create a significant agro-industrial and food processing industry. Attempts to encourage foreign direct investment have met with limited success. Consequently, the Kyrgyz government is quietly encouraging Accession to the WTO by all neighboring countries. Once countries are WTO members, the Kyrgyz government believes that all CAR countries will have an independent and largely impartial body to address cross border issues affecting trade and investment to the entire region.

In the meantime, the Kyrgyz government is moving ahead with reform on a number of fronts. The government has placed strong reliance on donor programs to assist the government to achieve the proper measure of reforms. Land reform is in the final stages of development with a new land reform law. The government wants to eliminate the constraints from the land market to enable farmers and businesses alike to obtain the needed financing for their businesses.

The government is about to finish the new Law on Water Users Association to develop the public/private institutional management and cost recovery mechanisms that the dilapidated irrigation system needs. A new Law on Water is also drafted and supported by the Ministry of Agriculture. Nevertheless, the country is a long way from establishing functional WUAs but the beginning is certainly near. The government knows and understands that the newly privatized farms are largely now owned and operated by farm workers, not farm managers, and therefore wants to promote the Rural Advisory Services sponsored by the WB/ADB for providing the needed agronomic consulting services to farmers.

Agricultural and rural finance are top concerns. The government believes that the Kyrgyz Agricultural Finance Corporation (KFC) is the most promising agricultural credit delivery system and yet its volume is still too low, interest rates too high, and security requirements too high. The government believes that KFC is not sufficient for the rural sector needs as it only meets between 25 to 30 percent of rural business needs. The government wants to encourage commercial banks to develop more business in the rural sector.

In order to achieve the level of agricultural reforms needed for the Kyrgyz Republic, the Ministry believes that investment in the institutional capacity of the Ministry is a must. Full automation as well as training and technical assistance to the midlevel agencies and officials is clear. These are the areas that are the front line to the public and implements and manage the regulatory and administrative rules and approvals. The Ministry has already decreased the number of licensing requirements fivefold for cross border transport of seeds, CPCs, fertilizers and food products.

## Banking, Microfinance Institutions, and Credit Unions

### Banking

The banking system of the Kyrgyz Republic is a two-tier system comprised of the National Bank of the Kyrgyz Republic (NBKR) that performs all central banking functions, and 20 commercial banks headquartered in Bishkek. The financial sector is supplemented with a few donor-funded nonbank financial institutions, and several donor-supported and developing microfinance institutions (MFIs). The capital markets (largely limited to government securities), insurance companies, and pension funds are very small, embryonic and not yet a significant impact on financing the economy. The Russian financial crisis hit the Kyrgyz banks hard as many of their banking operations involve business and trade with Russian banks and enterprises. After the crisis, many Kyrgyz banks were left with low capital and poor quality loans. Total banking assets were a low \$35 million as of January 2003.

Only two banks are government owned—Savings and Settlement Corporation (SSC) and Kairat—largely due to their bankruptcy following the Russian financial crisis of 1998. While these banks control 12 percent of the country's banking assets, their banking licenses are limited and closely supervised. SSC, the former Sberbank, is restricted to:

- Savings deposits
- Interbank lending
- Government securities transactions
- Fiscal payment services
- Government budgetary payment services.

Kairat bank is similarly restricted to deposits, cash transfers, interbank lending, and foreign exchange transactions.

Some positive developments are occurring. The Kazakhstan investment community is taking a strong interest in investing the Kyrgyz banking industry. In 2002, KazKommertsbank, one of the leading Kazak merchant banks, purchase a 75 percent interest in the Kyrgyz bank, Aftobank, later renamed KazKommertsKyrgyzstan Bank. In a second banking investment, EBRD purchased 25 percent and a Kazak bank, TemirBank, purchased 46 percent interest in Kyrgyzstan Ineksimbank resulting in a bank with about \$11 million in assets and \$4 million in share capital. The Kazak banking industry is significantly more developed in institutional capacity and managerial talent, depth of financial resources, and sophisticated banking instruments and structures to build business growth. These investments should improve the quality of the banking business in Kyrgyzstan, access to longer term financial resources, and increase competition for potential banking business.

#### *1. Bank Supervision*

Following the Russian crisis, the NBKR has worked hard to improve the prudential oversight and the quality of Kyrgyz banks. Nine problem banks were closed and minimum capital requirements were increased on the remainder. The NBKR adopted a Capital adequacy, Asset

quality, Management, Earnings and Liquidity (CAMEL) rating system for assessing the relative financial risk of a bank and the concomitant levels of regulatory oversight and supervision needed, including closing and liquidity, to avoid systemic effects on the banking system. More bank regulatory reform remains, including improved and stricter accounting and auditing standards and stronger bank corporate governance. Improvements in bank supervision do not improve the banking system alone. The judiciary must also cooperate by enforcing bank compliance with the NBKR's regulatory and supervisory action when regulatory persuasion fails.

Importantly, the banks themselves must undertake internal measures to improve their operational practices and efficiency as well as have a growing economy to enable them to grow out of their financial weaknesses. Banks need to upgrade staff to improve their ability to assess creditworthy borrowers and to learn how to finance smaller clients profitably. Currently, there appear to be too many banks chasing too few corporate clients leading to such stiff competition that the lending terms are not very profitable for banks. The Kyrgyz banking environment can be generally characterized by:

- Many capital weak banks unable to conduct new business except with the less risky financial transactions
- Interlocking directorates with cross ownership between banks
- Lack of quality enterprises that generate sufficient funds to service commercial debt
- Declining commercial borrowing of existing clients due to slow economy
- Declining asset quality of remaining loans of borrowers unable to pay down their outstanding balances
- Nonperforming loans increasing and declining credit quality depending upon the number of loan rollovers due to borrowers' inability to pay
- Lack of trained loan officers able to assess a loan applicant's business operations and evaluate the credit risk that the loan application presents
- Declining income from placement of funds in foreign correspondent bank accounts due to declining global interest rates
- Low margin and low demand for commercial banking services
- Lack of public confidence in banking system after the Russian financial crisis
- Inefficient payments system
- Lack of certainty in commercial law decisions and lack of effective pledge law.

Kyrgyz bank officers are reported to demand cash payments of 10 to 30 percent to receive a loan. These reports are naturally difficult to verify, but are common in transitioning economies until management and owners realize that these practices are present and that higher loan losses occur from such practices.

Public confidence in the banking system is reported as low with a concomitant low savings mobilization ratio. It is said that banks have difficulty obtaining deposits due to customer fears that the tax authorities will simply confiscate their account to pay for taxes. Others suggest that banks do not want the funds.

Deposit insurance has been suggested as measure to restore public confidence in the banking system. This is premature and potentially dangerous to the banking system. The banks do not show any signs of needing liquidity from the deposits that such insurance would likely generate. Indeed, corporate lending has been declining as well as with credit quality. Deposit insurance enables bank managers to mobilize significant financial resources for lending to high-risk commercial projects. If the projects fail, the deposit insurance or the government must cover the losses or risk destroying public confidence in the banking system for another decade.<sup>1</sup> Deposit insurance should only be introduced in a stable banking environment where a strong bank regulator and an effective judiciary are present.

More banking reform is needed. NBKR must have access to all necessary banking information to develop valid and supportable supervisory actions. Improvements are reportedly still needed in the off-site examination and supervisory areas in terms of obtaining proper information as well as effectively analyzing it. Workloads of quality bank supervisory officers must be dedicated to appropriate examination functions. Modern bank supervision has established computerized data collection and preliminary analysis to red flag supervisory problems for bank examiners and supervisors.

NBKR supervisory actions have been frequently challenged in the Kyrgyz courts with many decisions going against the NBKR. The reported corruption of the judiciary and the slowness of obtaining judicial decision limit the effectiveness of NBKR supervisory decisions with uncooperative bank managements. Improving a nation's judicial system and eliminating corruption is a daunting and difficult task, but this must be done if there is to be an effective regulatory system.

As a matter of financial legal infrastructure and government integrity, much reform remains in the area of creditors' rights, pledge and collateral systems, and judicial enforcement procedure. These areas are poorly developed and judicial enforcement is uncertain and inconsistent. This again reflects the quality and integrity of the judiciary. Corruption is reported at all levels of government, particularly with respect to any licensed activities. Transportation, fire, safety, and tax authorities frequently visit financial institutions or their customers, extracting payments to avoid violation reports, fines, and disruption in operations.

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<sup>1</sup> The risks of governments covering deposits in excess of insurance does not only occur in emerging markets. The US taxpayers had to pay for the \$100 to \$150 billion shortfall in deposit insurance for failed savings and loans in the 1990s largely due to unscrupulous lenders in speculative construction and real estate loans.

## *2. Financing Agriculture and the Rural Areas*

Following independence, the Kyrgyz Republic continued financing agriculture under the Soviet era system until appropriate reforms could be undertaken. Only the state-owned Agroprombank financed agriculture and the rural sector of Kyrgyzstan with subsidized financing rates and terms. When more than 90 percent of its assets were nonperforming loans to failing state enterprises, Agroprombank was liquidated in mid-1994.

Commercial banks were then free to lend to the sector but very few agribusiness or agricultural producers were bankable. Most commercial banks are headquartered in Bishkek with branches in the Chyuski and Osh region. Very few branches are located in the remainder of the country to provide rural financial services. In addition, the banks' institutional capacity and the financial legal infrastructure are not sufficiently developed to safely finance agricultural loans. Agricultural land had been distributed, but only through land lease rights and it was not clear that these rights could be mortgaged. Private agribusiness enterprises and food processing firms have little capital and insufficient operational experience to make them good credit risks. Commercial bank loan officers lack skills or experience in risk analysis and business plan evaluation. With these impediments and the low margins on agricultural lending, commercial banks are more interested in searching elsewhere for profitable banking business.

With little commercial lending to supplant the liquidated Agroprombank,<sup>2</sup> the Kyrgyz government chose to channel credit to farmers through provision of inputs (seed, fertilizer, CPCs and fuel) in exchange for repayment at harvest. The result, a non-repayment culture by agricultural producers, was not surprising. The former Agroprombank merely allocated Soviet and later Kyrgyz government budgetary funds to agriculture where production of food for the population was key and not repayment. After independence, the proceeds from sales of process products went into the hands of the processor director and farm manager or were simply not paid by the buyer—particularly buyers from other former Soviet republics. Agricultural producers were unfamiliar with an obligation to repay for government provided inputs and did not feel obligated to repay the government credits.

## *3. Kyrgyz Agricultural Finance Corporation*

After assessing many agricultural credit approaches used in other countries in 1996, the Kyrgyz government with the help of the World Bank tried an alternative approach. The government established a nonbank financial institution, the Kyrgyz Agricultural Finance Corporation (KFC), in late 1996 with the first operations in May 1997 to serve the rural areas. Its early organizational development was uneasy as there was no nonbank or MFI law and lending was legally restricted to banks chartered under the law on banking. Prudential regulation and supervision came under the Kyrgyz central bank but without a clear statutory and regulatory framework. The KFC was established as a wholly owned government corporation, with the stated intention of privatizing the KFC after it was fully established as a profitable commercial institution. The six-member Board of Directors was comprised of the Chairman of the State Property Committee, the

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<sup>2</sup> The state savings bank Sberbank was also liquidated during this period. Agroprombank and Sberbank had the largest branch network throughout the country. Liquidation of both banks at the same time meant that a large number of rural communities immediately were without formal financial services.

Executive Director of KFC, three directors representing private farms or agribusiness enterprises, and the Minister of Finance serving as Chairman. Organized and operated as a commercial entity, the KFC receives its loanable funds from the state budget of the Kyrgyz Republic primarily as onlending funds of the World Bank and ADB. In its early development, the KFC received substantial technical assistance from TACIS and the Rabobank International Advisory Services.

The KFC corporate mission is to finance any profitable business in the rural area. Target customers include private farmers, processing enterprises, joint stock companies or cooperatives, and any entrepreneurs conducting profitable businesses in towns and villages. Due to the limited level of economic growth in rural areas and the limited assets of entrepreneurs, the KFC largely became a rural microfinance lender with individual collateralized loans and non-collateral group lending. The main features of KFC lending are as follows:

- Individual and enterprise collateralized loans from \$300 to \$1500 with an average loan size of \$300.
- Group lending loans to the poorest of the poor with group members receiving up to \$300 each based on their business. Groups are not to exceed ten members and each member should not have income of more than \$30.
- Primary rural economic segments financed by KFC include:
  - Agriculture (crops of all types, livestock production, fish breeding, apiculture)
  - Agribusiness processing, packaging, warehousing
  - Tourism, food service and catering, hotels and bed and breakfast units
  - Trade in village and regional bazaars
  - Other businesses supported by business plans.
- Loan products include:
  - Short term loan of less than one year
  - Medium term of one to three years
  - Long term (largely equipment) loans up to seven years but not beyond useful life of the equipment.
- KFC also provides funds transfer services, information services on lending, and bank products.

In its initial organizational structure, developed in conjunction with WB and later ADB lending programs, the KFC was intended to be privatized after it reached financial and operational sustainability. KFC is currently working with the TACIS/RIAS team to work out a privatization strategy for presenting to its board of directors and then to the Kyrgyz government.

The basic steps of the KFC banking and privatization strategy is as follows:

- Developing a comprehensive strategy and action plan for obtaining a full banking license with the NBKR



- Initial banking operations limited to its institutional capacity—limited current account deposits and savings products, funds transfer, term certificates of deposit, treasury functions, and retail loan products
- Preparation of three-year business plan with:
  - Full projected financial statements (balance sheet, profit and loss statement, and cash flow statement). Operational expenses broken down into a detailed three-year budget.
  - Detailed description of the organizational structure and banking operations
  - Human resources development plan, including training as required
  - Full explanation of all banking products
  - Comprehensive operating manuals of bank policies and procedures adopting international banking practices tailored to the level of KFC's bank operations
  - Management information system for fully computerizing all KFC operations.
- Proposed method and approach for privatization of KFC.

### **Law on Microfinance Institutions**

In August 2002, the Kyrgyz Republic adopted a Law on Microfinance providing for the formal registration and licensing of MFIs with the Ministry of Justice. All MFIs registering with the Ministry may continue their microlending operations in accordance with the powers and responsibilities granted them under the law. Otherwise, the MFI's authority to extend microfinance products and take deposits from their customers expires with the end of support of their donor sponsors.

MFIs that apply for registration will be assessed for sustainability and current financial statements will be examined by the NBKR. Registered MFI will be granted powers based on organizational and operational financial strength and managerial capabilities.

### **Economic Policy Secretariat**

In May 2001, the Kyrgyz Republic established an Economic Policy Secretariat that operates as an investment/business council to advise the President on adopting measures to attract foreign investment, particularly in the areas of hydroelectricity, mining, tourism, information technology, food processing, and services. The Secretariat is comprised of representatives from the government, major private firms, business and trade associations, donors, and bankers. The Secretariat meets quarterly and is supposed to focus on government bureaucracy at all levels—national and local—and recommend reforms and approaches for reducing and minimizing

bureaucratic red tape. Government regulations and administrative practices have changed as a result of some of the efforts of the Secretariat.

The Secretariat meets annually with the President for two days to discuss the state of the economy and remaining barriers that international investors see discouraging investment in the Kyrgyz Republic. The Chairman of the Secretariat is a Deputy Prime Minister and former Minister of Industry and Economy Jamar Otybaev, who has frequent access to the President to discuss economic policy issues.

## **Commercial Law**

### **Accounting**

A new Law on Accounting adopted in April 2002 introduces improved financial reporting requirements on the basis of international accounting standards. All legal entities and businesses are required to comply with the new accounting regulations by year end 2004. This phase is ambitious and may need adjustment. Not only is there limited accounting understanding of the new requirements within firms but also limited accounting professionals.

### **Arbitration Court**

Arbitration courts or panels have been pushed by financial institutions and trade associations as a method of achieving swift resolution of commercial disputes outside the cumbersome, slow, and corrupt judicial process. The government adopted a commercial arbitration process in 2002 but the results are not yet clear. There are reports that arbiters are equally corrupt as judges, charging \$50 per case to favor one party's position.

### **Pledge Law**

The current pledge law is woefully inadequate for a modern commercial market. Some of the arcane characteristics of the current law are as follows:

- The loan must be greater than 50 percent of the collateral value of the loan or the pledge is likely to be cancelled by a court.
- Repossession takes a very long time and the court determines the actual value that the creditor is able to realize from the foreclosure excluding any costs of foreclosure.
- Anyone having any remote interest in the property can attend the hearing and be heard on the foreclosure having an effect on the value that the litigating creditor may realize. Priority is not a consideration.
- A typical foreclosure may involve 15 to 20 hearings.
- If any unanticipated event causes a force majeure, then the loan is extended by one year.

Reform in the pledge or collateral laws has been developing for sometime under a WB economic reform project. A draft pledge law was prepared and reviewed by a number of business associations and donor supported commercial law advisors. By the time it was introduced into Parliament in May 2003, however, Parliamentary committees changed numerous provisions that limited the commercial effectiveness. Tilting pledge law in favor of pledgees only limits lenders' willingness to lend against the collateral. Some of the objectionable features of the new law include:

- Mandatory registration of all collateral pledges adding \$10 to \$30 in fees to each loan making individual microloans and many SME loans prohibitively expensive.
- Mandatory registration is not, however, required for mortgages of land under a certain amount, creating huge potential invisible clouds on the title of land.
- Lack of efficient electronic registry to improve the ability to search for prior liens on collateral.
- Pledge law draft does not change important provisions of other laws, such as the Agricultural Land Governance Law to make pledges or mortgages on agricultural land a reality rather than a theoretical possibility.
- New law does not yet have clear and precise rules for foreclosure on collateral, making the process certain and swift.
- New law does not make it clear that foreign creditors or owners of land and collateral have the same protections as Kyrgyz citizen creditors or owners of land and collateral.
- New law does not make clear that pledgees of collateral have full access and operational use of the collateral while the property is pledge; otherwise, the pledge has limited use for financing new plant and equipment.

Favorable resolution of these defects in the Pledge Law moving through the Parliament is critical to opening new channels of financing for the entire value chain of the agricultural sector from production through retailing. Many Kyrgyz business and trade associations and donor projects commented on the draft law and tried to reverse the Parliamentary amendments.

## **Land Reform**

After Kazakhstan, Kyrgyzstan has been the most progressive in initiating and implementing land reform. Large portions of land, including agricultural land, have been privatized to a large portion of the Kyrgyz population. However, the distribution process has not been without problems, many of which are beyond government control, including:

- Large mountainous regions limit available land: average land plots 0.2 to 0.4 ha.

- Local tensions on access and use of land. Many believe that they were unfairly treated and that local official favorites received larger and better pieces of land.

Land condition and environmental excesses of the Soviet times have degraded much arable land. Pesticides, herbicides, and fertilizers were often overused in an effort to increase yields. The crumbling irrigation system has exacerbated soil fertility. Problems include:

- Land has high salinity in some areas and waterlogging in others.
- There is much land terracing to plant crops on difficult terrain, and trees and forests have frequently been removed for fuel and farm land.
- Primary and secondary canals and drainage systems need repair and maintenance.
- Because land titles are registered in the man's name regardless of original ownership, lending to women-owned micro or SME businesses is complicated.

Much reform needs to occur with the laws relating to mortgaging of land. Under current law, a lender cannot lend against land that is substantially greater in value than the amount of the loan. This requirement forces the lender to lend more against the land than it would otherwise to avoid having the mortgage voided by a judge. This practice, however, increases the credit risk of the lender and is a fundamentally unsound banking practice from a prudential regulatory perspective.

## **Leasing**

Equipment leasing is governed by the Civil Code (1998) and the Law on Leasing enacted in July 2002 and follows the financial leasing approach for equipment and non-real estate leasing. Under these laws, leasing is a transaction in which the lessor purchases an asset (any nonconsummable good, except for real estate or natural objects) selected by the lessee from a supplier for use by the lessee for commercial purposes for a definite lease term. This transaction must be a complex transaction requiring several agreements for sale, lease agreement, insurance, and maintenance. In addition, one of the following transaction classifications must be met:

- The leased asset is transferred to the lessee at the end of the lease for its then fair market value;
- The leased agreement is for more than 75 percent of the economic life of the leased asset; or
- The present value of the lease payments at the beginning of the lease term should be no less than 90 percent of the value of the leased asset.

Other characteristics of leasing in Kyrgyzstan include the following

- Leasing does not require a license from any licensing authority—except when a bank or other lending institution engages in leasing. Bank and nonbank institutions must have included in their banking licenses the authority to undertake leasing activities.

- Lease agreements must be in writing and include all terms and conditions of the lease including
  - The lease term
  - Lease payments
  - The terms of delivery of the leased asset
  - The rights and obligations of the lease parties
  - Default and remedy provisions.
- Lease agreements do not have to be notarized.
- Subleasing is permitted with authorization from the lessor.
- Lessee can work directly with the supplier or manufacturer of the equipment to address any issues of quality, the delivery and installation, or warranty.
- Lessor cannot sell the leased asset to a third party unless that party becomes the lessor of the continued lease of the equipment to the lessee.
- Insurance is not obligatory, but the agreement must assign responsibility for insurance of the leased asset.

The most important weakness of the Kyrgyz Law on Leasing is the lessor's rights of repossession. The lessor is provided with the right of titled ownership of the leased asset and the right to repossess the leased asset, but only in accordance with general court procedures and not through an internationally typical provision for expedited repossession or through a non-judicial repossession mechanism. In effect, this makes the lessor's repossession right illusory due to the lengthy Kyrgyz court system and the reportedly corrupt judicial system. A court case can proceed through a trial and two appellate courts before final resolution and can take more than a year.

The IFC has proposed two alternative mechanisms to address this problem: commercial arbitration or a notary writ. The government responded by adopting an arbitration court system for non-judicial resolution of commercial transactions in 2002. The arbitration court system has two advantages:

- An arbitration court has no appeal and its decisions are effective immediately.
- Parties can select their arbiter and significantly reduce their costs from what would be charged in the Kyrgyz judicial system.

The only drawback to the arbitration court is the uncertainty of the effectiveness of the arbitration court decision. If the losing party does not agree with the decision, it is not clear that it is enforceable in the general Kyrgyz judicial system. In addition, enforceability requires going through the Kyrgyz judicial system.

The IFC proposal to allow the use of notary writs to enable immediate possession of the leased asset is under advisement of the Ministry of Justice and being reviewed by all other Ministries. If reviewed positively, a provision for repossession by notary writ may be adopted by Presidential decree.

Accounting for leased assets is not yet clear. Kyrgyz Accounting Standard No. 17 provides that the lessee account for the value of the leased asset at fair market value or the present value of the lease payments, whichever is less. The lessee would depreciate the asset but there is no normative schedule or basis for depreciating leased assets at this time. To a degree this is resolved by the Kyrgyz Republic announcement of adoption of International Accounting Standards (IAS) by 2006 and allowing companies to choose between the administrative system of accounts or IAS until then. Under IAS No. 17, leases are clearly classified as financial or operational leasing depending on the degree that all risks and rewards incident to a lease are transferred to the lessee. Accounting and depreciation rules under IAS are clearly defined.

For tax purposes in the Kyrgyz Republic, a lease must be at least 12 months and meet one of the following conditions to be treated as a lease.

- The lease transfers ownership of the leased asset to the lessee by the end of the term;
- The lessee has the right to purchase the asset at a price fixed in the lease;
- The lease term is for at least 75 percent of the economic life of the leased asset;
- At the outset of the lease, the net present value of the minimum lease payments is at least 90 percent of the fair value of the leased asset; or
- The leased assets are so specialized that only the lessee can use them without major modifications.

The Kyrgyz tax authorities view a lease agreement as the sale of equipment to the lessee, and as such, tax the lessee as the owner of the equipment. Lease payments are viewed as credit or loan payments to the lessor having an interest and principal component.

The Kyrgyz Tax Code has unusual limitations on deductions for interest expense. A taxpayer may only deduct interest based on a formula: 1) in an amount equal to the total loan principal payable during the tax year multiplied times 1.5 the NBKR refinancing rate at the time the debt was obligated; and 2) interest deducted may not exceed any interest income of the taxpayer plus 50 percent of its taxable income less interest income and expenses. This complicated tax formula is intended to limit borrowing, particularly external debt. Deduction of lease payments is also limited by this formula on interest expense limitations after determining the interest and principal components of the lease payments.

VAT is levied only on the value of the asset as purchased by the lessor. In addition, VAT is levied on the principal portion of the lease payments for the lessee. Lessors also receive the right to offset the VAT based the stated invoice upon transfer of the asset to the lessee as a leased asset. Finally, VAT is not levied against technical equipment imported as part of the initial capital of a company for its own commercial use or against equipment imported for leasing for commercial purposes.

### **B1c. Commitment of government to reform**

Kyrgyzstan, one of the poorest of the former Soviet Republics, has initiated a number of reform measures to restructure the Soviet planned economy into a market driven economy from the beginning of independence. Privatization of state-owned enterprises was begun in 1991 followed by financial and agrarian reforms in mid-1992. With USAID assistance in the mid-1990s, Kyrgyzstan applied to become a signatory of the GATT, predecessor to the WTO. After an intensive three-year process, the Kyrgyz Republic became the first former Soviet republic to become a member of the WTO in 1998 and it remains the only WTO member country in the region.

The Kyrgyz Republic had few choices to develop and stimulate economic growth but to adopt structural economic reforms and liberalize its trade regime. Unfortunately, the reforms alone have not had the dramatic economic growth the government sought. The still relatively closed trade regimes of its neighbors (primarily Uzbekistan and Kazakhstan) limited the full effect of its reform program. Geographic isolation, scarcity of natural resources, a heavy dependence on gold, and the debilitating effects of the 1998 Russian financial crisis kept the Kyrgyz Republic poor despite its development of a modern financial and legislative regime developed to support and foster private enterprise development. Border closing and customs issues and high border transaction costs with Kazakhstan and Uzbekistan have limited the potential for Kyrgyz business development. A somewhat xenophobic fear of foreign ownership of major Kyrgyz businesses has also limited foreign investment in the Kyrgyz economy to some extent.

Despite the limited gains to date, the Kyrgyz government is convinced that its economy will only start to develop a sustainable growth pattern when goods and services are able to flow through the region and particularly with its most important trading partners, Kazakhstan, Uzbekistan, and Russia. For these reasons, the Kyrgyz government believes that it must move forward to implement the WTO protocols and bilateral agreements to demonstrate its continual commitment to open trade. In addition, in regional and bilateral meetings and conferences, the Kyrgyz government encourages and supports its neighbors' entry into the WTO as a method of facilitating trade in the region, minimizing border issues, reducing regional fees, duties and nontariff barriers, and enabling the country to achieve higher economic growth.

### **B1d. Primary agriculture (Production)**

#### **Overview**

Kyrgyz agriculture is diverse. Of 10 million hectares of agricultural land, there are 1.5 million hectares of arable land in lowlands under intensive production, and 8.5 million hectares of upland grasslands and pastures under extensive livestock grazing. The country broadly splits into two main parts: the heavily populated and climatically warmer South consisting of two *oblasts*, Osh and Dzhalaal-abad, separated by the Tien Shan mountains.

Most of Kyrgyzstan is mountainous, with about 70 percent lying over 2000 meters. Because of the continental climate, only one cropping season is feasible and cultivation is found mainly in the plains (the Chui valley around the capital Bishkek, the fringes of the Fergana valley in Osh

and Dzjalal-Abad *Oblasts* close to the Uzbekistan border, along the narrow Talas valley, and around the shores of lake Issyk-Kul). Irrigation is essential for reliable sustainable crop production. The generally dry climate promotes relatively disease-free growing conditions, well suited for seed and fruit production.

## Agricultural Land

The Asian Development Bank reports that although the moratorium on the sales of agricultural land was lifted on September 1, 2001, there has not been a sharp rise in land transactions. Land sales have been limited because of major restrictions due to political conditions that emphasize safeguards against speculative transactions and concentration of land assets. However, there is growing domestic pressure for the government to ease restrictions on land transactions to recognize the individual rights of landowners, facilitate farm consolidation, promote enterprise development in agriculture, and allow efficient producers to use their land assets more effectively as collateral. The current restrictions have made land an unattractive choice for collateral to creditors.

Kyrgyzstan has about 1.4 million hectares of arable land, which is only about seven percent of the nation's total area. More than 70 percent of the arable area depends on irrigation for its productivity. In the Soviet period, only about four percent of agricultural land was owned privately, although private plots contributed a much higher percentage of overall output, especially in fruits and vegetables. In 1994 only an additional six percent of agricultural land had passed to some form of private ownership. The privatization of land was disputed by President Akayev and more conservative government officials. The latter reflected the Soviet-era view that land should be common property protected and disposed of only by the state. More immediately, these officials represented the interests of state farm administrators whose enterprises suffered greatly from post-Soviet economic shocks and redistribution of resources.

The Kyrgyz Government started land reform in 1991. As a result of the Law on Land Reform and Law for Creation of Peasant Farms, by the end of 1991 there were about 2,000 farms established, holding about five percent of the farmland. These farms were generally very small—the land share per capita was 0.05 - 1 ha. Subsequent presidential decrees to dismantle the unproductive *kolkhozes* and *sovkhozes* and enhance the reform followed, and as a result, different types of farming entities were created. The land privatization process was said to be completed in the end of 1999, with the breakdown of farm-management structures as follows:



**Table 1: Land Use After Privatization**

Category	No. of land users	Irrigated land '000 ha	Irrigated land percent	No. ha per user
1. Private farmers	76,775	111.6	10.5	1.6
2. Peasant farms	26,214	308	29	11.8
3. Collective peasant farms	222	149	14	670
4. Agr. joint-stock companies -JSC	83	22.4	2.2	270
5. Agr. co-operatives	304	97.2	9.1	320
6. State farms	159	61.3	5.7	390
7. Village Committees	346	117	0.9	340
8. Household plots	617	19.8	1.8	32
9. State Reserve	390	56.9	5.3	145
10. Towns and settlements	26,781	120	11.5	4.5
<b>TOTAL</b>	<b>131,545</b>	<b>1,066</b>	<b>100</b>	<b>8.1</b>

Source: State Department for Land Management

Considering the economies of scale, the small private farms do not seem to have a prosperous future. The outlook is better for peasant households, representing almost 30 percent of the irrigated lands. Their members work hard and generally are able to pay their subsidized water charges. The collective peasant farms operate collectively and divide their outputs more or less like the earlier large collective farms. Although they have good prospects because they farm larger areas, they do not achieve the same productivity per unit of land as the peasant farms. In addition, their members do not know where their allocated share of land is because they agreed to put it into the joint management. Should they request to farm on their own, they are given a piece of land outside the collective farm territory of generally inferior value.

The number of land users is changing since the process of shaping the agriculture sector is still ongoing. In 1990, there were 850 to 900 land users in the republic (and the same number of water users); in 1999 131,500. Such an increase has created serious difficulties in the operation of irrigation systems and water distribution.

According to the privatization law, state agricultural assets are distributed according to a share system in which all citizens have the right to a garden plot, but only individuals in the rural population have the right to occupy land and other agricultural assets formerly owned by state and collective farms. Recipients of shares can maintain the property as part of the collective, transfer it to a cooperative, or establish an individual farm. In the early 1990s, the former alternative was much more popular because of the perception that larger units offered greater security in a time of financial uncertainty. Private ownership of land remained illegal in 1995, but use rights are guaranteed for 49 years, and use rights can be bought, sold, and used as collateral for loans. In 1994, a new decree on land reform expanded and clarified the legal basis for the use and exchange of land and improved the administration of land privatization, which is the responsibility of the Ministry of Agriculture and Food.

Although the enabling law for establishment of WUAs was effective in 1997, the formation of WUAs and transfer of operation and maintenance to them could be enhanced by establishment of a land market in which land can be sold, bought, and used as collateral. This would eliminate fragmentation of the individual land holdings, which is presenting difficulties in harmonizing the cropping pattern, using water efficiently, and achieving sustainable agriculture production.

Relevant Land Code was passed by the Parliament in the spring of 1999. The Land Code was revised twice, (most recently in 2001), leaving 30 percent of the land in the state reserve fund. The collective farms have rights to use land but do not have land certificates. At present, the decree that changes the 99-year land use rights is in effect and already in a few *raions* the land-use certificates are being changed into legal land-ownership certificates by putting a stamp on them. For this purpose, the State Agency for Land Registration has offices in the *raions*.

## Agricultural Production

The chief crops are fodder crops, wheat, barley, and cotton. Other agricultural products are sugar beets, tobacco, fruit, vegetables, and silk. In 1994 the largest crop harvests were of wheat (611,000 tons), barley (300,000 tons), potatoes (288,000 tons), and tomatoes (160,000 tons). The primary agricultural use of land is pasturage for livestock, mainly sheep, goats, and cattle, the husbandry of which is the traditional vocation of the Kyrgyz people. An estimated 83 percent of land in agricultural use is mountainous pastureland. In 2002, horticultural production levels increased by 4.6% and livestock production increased by 1.8% over 2001 levels. Also, the production of grain in 2002 was 1.9 million tons, cotton 99 thousand tons, and 525 thousand tons of sugar beets. All increases over 2001 levels of production.

## Fruit and vegetables

This section has been taken from the Helvetas – Kyrgyz Swiss Agricultural Project (KSAP) - Fruit and Vegetable survey in October 2001. There has been an increase in domestic vegetable production due to the increased demand from the neighbouring states primarily Kazakhstan and Eastern Russia (Siberia), which take 97 percent of all Kyrgyz fruit and vegetable exports. Kyrgyzstan has exported significant quantities of onions and tomatoes to Siberia. The increase in demand has stalled since the August 1998 Russian economic crisis. At Siberian markets the range of Kyrgyz produce included onions, garlic, tomatoes, peppers, apples, pears and plums.

In 1997, Kyrgyzstan exported US\$ 17 million of vegetables, of which 86 percent was traded with Russia. Onions, apples and pears predominate—each crop representing approximately 30 percent of the total exports. A certain proportion of fresh produce transactions is in the informal sector and not registered by the national and *Oblast* statistics; however, the statistics do provide an understanding of trends.

Kyrgyzstan has experienced a significant rise in the overall production of vegetables in recent years, from 368,000mt in 1996 to 555,500mt in 1998—a 50 percent increase. Vegetable production has increased by over 100 percent since 1994, and the trend is continuing. The national distribution shows a heavy concentration of production in Chui *Oblast*, which currently composes 40 percent of the total national output.

Rising vegetable production is a direct result of the break-up of state farms and small private farmers entering into the cultivation of what is considered a more profitable crop. It is less regulated than grains and not such a drain on the farmer's financial resources as fruit. Potato production has also increased over the last four years. Chui and Issyk-Kul *Oblasts* produce over half the country's potatoes. The volume of potato production exceeds that of vegetables.

Fruit production includes apple, pears, peaches, plums, cherries, apricot and a range of soft fruit. The increase in production has not been as steep as that of vegetables and potatoes primarily because the capital requirement to produce the crop and the length of time needed to enter into profitability. The main fruit production *oblasts* are Osh (16,000 ha), Chui (10,200 ha), Issyk-Kul (7,300 ha) and Jalalabad (6,500 ha). Grape production is limited to three *oblasts* of which Chui and Osh predominate.

### Agricultural Trends and Problems

The early 1990s saw many farmers turn from commercial production to subsistence crops, a trend that hurt the country's export activities (roughly half of its exports were agricultural in 1990) as well as the availability of foods within Kyrgyzstan. Experts believe that Kyrgyzstan's main agricultural problems are inappropriate and slow-moving reforms (especially land redistribution), intrusive bureaucratic regulations, poor availability of credit, and delayed payments to farmers for their crops. More immediately, both irrigation water and fertilizers have been in short supply since the end of the Soviet Union. In addition, Kyrgyzstan's agriculture uses an average of less than 50 percent of the amount of pesticides used by agriculture in the western nations.

In 1994 the agriculture sector was in the fourth and most difficult year of a major decline that included reduced output, isolation from commercial markets, decreased earnings, and a deteriorating natural resource base. Total agricultural output dropped by 17 percent, and the decline in marketed and processed output was substantially greater because of the trend toward subsistence farming. Production ceased to increase at about the time of the collapse of the Soviet system, an event that initiated the loss of markets and trading partners, the loss of transfer payments from Moscow, and a condition of general monetary instability. The national government did not address these problems effectively in the first years of independence; in fact, government marketing quotas, price controls, and trade restrictions exacerbated the decline. By restricting farmers' marketing and pricing practices, the government in effect levied a tax on agriculture that redistributed income to other sectors of society. National reforms in land tenure, farm organization, and the financial system, together with privatization of services, were eroded by the continued authority of local officials to interfere in administration of those reforms. A key agricultural resource, pastureland, was degraded severely by the Soviet-era practice of mandating livestock populations too large for available pasturage on state farms and by post-Soviet transfer of livestock from inefficient collective and state farms to private ownership without limiting grazing rights on common pastures.

In the 1980s, livestock production accounted for about 60 percent of the value of the country's agricultural output, including mutton, beef, eggs, milk, wool, and thoroughbred horses. In 1987,

when herds reached their largest numbers, about twice as much grain was used for animal feed as for human consumption. However, the prices and demand for livestock products have dropped significantly in the 1990s relative to those of crops.

In the mid 1990's the most important livestock products were cow's milk (750,000 tons), beef and veal (70,000 tons), mutton and lamb (50,000 tons), eggs (30,600 tons), wool (56,300 tons), pork products (30,000 tons), and poultry meat (25,000 tons). In 2002, Kyrgyz households produced 356 thousand tons of meat, 1.2 million tons of milk, and 243 million eggs. Potato production increased by 6.5% over 2001 levels and farmers received a 44% increase in the price paid at the farm gate. Vegetable production increased by 1.6% over 2001 levels, but the average price received declined by 4.9 percent.

Small traders, market intermediaries, and competition in input supply and output marketing have begun to emerge in several regions. Farmers as primary producers are exempted from value-added tax (VAT), while market intermediaries are not VAT exempt. Small traders often operate informally, and porous international borders have enabled smugglers of fertilizers and agrochemicals to capture sizable domestic market shares, and gain an unfair advantage through tax evasion and uneven application of VAT. The Kyrgyz Republic does not produce its own fertilizers and agrochemicals, and relies on imports. The pervasive smuggling and the uneven tax application dampen the development of formal trade and contribute to tax evasion, although farmers benefit from the low-priced agrochemicals.

### **B1e. Agribusiness (food processing)**

The major objective in the development of the food processing industries in Kyrgyzstan should be to enhance linkages with agricultural production and markets. It is also necessary to increase exports of high quality processed products.

The number of the vegetable processing enterprises is about 12 percent of 590 enterprises of the food industry (about 35 plants and 18 mini-processing plants), registered in the statistical committee of the Republic. At present the number of actually operating enterprises is not more than 25. At most enterprises the workshops for production of tinned products don't work but the equipment is operable. Many plants were reoriented for production of alcoholic products and wine material, which are more profitable. Recently the trend has been for the growth of fruit and vegetable enterprises especially those that produce dried vegetables and juices.

Though the processing industries are still in poor condition, taking into consideration the possibilities of the raw material base and the amount of labor required for growing and harvesting fruits and vegetables, this sector is in better condition than the cattle breeding sector. The vegetables are mostly annual plants and it easy to plan their production. According to the official statistics for the past five years in Kyrgyzstan the production of tinned fruit and vegetables amounted to 4 - 4.5 thousand tons, though the total capacity of production is 25 thousand tons. In 2000 2.4 million conventional tins of tinned vegetables, 12 million conventional tins of tinned tomato and 4.1 million conventional tins of tinned fruit was produced. This amounts to 12 percent, 60 percent and 20 percent of total amount of produced tins (20.1 million conventional tins) respectively.

The processors have not been able to organize a system of raw material supply, create a trademark, and establish a system of distribution and sale. In this situation the small capacity enterprises that have been established for the past two or three years have become more viable. They are more mobile and have the right market approach to establishing and managing the business. Mainly they are being established when the demand is studied and the customer is defined.

Most of the processing plants strive to purchase appropriate packages for their production. This forces them to import the packing material, for example, glass packages (jars) from Uzbekistan and Russia, polymer packages from Russia, Turkey and Europe. Many of the managers of these processing plants falsely believe that their production problems can be solved just by purchasing such costly packing lines as Tetra Pak without undertaking any changes in the general system of management of the production process.

At present, many managers find themselves in an information vacuum: on the one hand there is a lot of disordered (and often contradictive) information, on the other hand, lack of clear reference marks for selection of perspective directions. The appearance of the production of most enterprises is not competitive even at the domestic market. From the availability of juices and tinned products in the shops, it is possible to draw a conclusion that the range of fruit and vegetable production mainly consists of imported products of such countries, as Hungary, Bulgaria, France, Germany, Kazakhstan and Russia. The production of the local producers has no advertisement support and organized distribution system.

## **B1f. Water resource management**

### **Background**

The main mountain ranges of Kyrgyzstan feature peaks up to 7,000 meters that are permanently snow-capped and provide abundant water resources through snow and glacier melt. According to the international agreement drawn by the ICWC, Kyrgyzstan is allowed to retain 24 percent of the water originating within its catchment area. However, the balance between irrigation water available and the potentially irrigable area varies tremendously between different catchments and different oblasts, causing local deficits of water that result in lower crop yields (as in Chui). The main source of water is directly diverted from the rivers (in Talas, Chui, Naryn and Kara Darya), some of which are partially regulated by reservoirs. There are numerous small streams flowing from the mountains. Groundwater is relatively less important.

Irrigation is the most important water use, using almost 90 percent of Kyrgyzstan's plentiful water resources. Irrigation is practiced on 1.066 million ha, on almost all arable land (1.2 million ha), and water is predominantly diverted by gravity and applied as surface irrigation by furrow and wild-flood. The crops under irrigation are wheat, barley, lucerne, maize, cotton, tobacco, vegetables and fruit trees. In areas with abundant water, rice can be found. Oilseed crops, including sunflower, safflower and oilseed rape are grown in the north, mainly on rain-fed land. Formerly, about 150,000 ha were irrigated by overhead sprinklers, center-pivot, and volume guns, but there are not used much now because of high operating costs (due to higher pricing for energy) and difficulties in buying spare parts. There are 5,440 km of drainage network, draining 146,800 ha of land (about 80 percent lie in the Chui valley). About 10 percent of lands are

classified lightly saline and a small percentage is water logged, both resulting in reduction of yield.

After independence, the irrigation sub-sector began to face typical transition problems: dilapidated infrastructure, lack of maintenance (from the late 80s), decreased land and water unit productivity, degradation of the socioeconomic conditions and the environment, and confusing and incomplete legal and regulatory framework—namely unclear land and water rights, and lack of clear irrigation operational rules, including equity in distribution of water and rent-seeking behavior.

## Water Reform

There was a vivid need for reform in the management of irrigation and drainage systems, which fell in an institutional vacuum as a result of disintegration of state and collective farms. Problems maintaining the infrastructure and the inter-farm (former on-farm) canals were gradually mounting. Landholders of small plots, as a result of agricultural reforms and land privatization were not easily dealt with for water contracts. The water providing entities – *raivodhozes* - faced difficulties in supplying water to the hundreds of miniscule plots, and (due to the decreased government budget allocations) had limited their O&M activities to a minimum. The central budget could cover only about 30 percent of the needed funds. It has become clear that a focus on irrigation strategy is eminent and the situation with deferred maintenance of the inter- and on-farm network must be remedied.

Therefore, new institutional arrangements and goals for the irrigation sector had to be devised. A water law passed in 1994 was amended in 1995 to allow farmers to form WUAs, even though little was known about the concept and principles of associations. In 1995, some WUAs were established, spawned either by a spontaneous action of individuals or activities of local water authorities staff. However, in general, the understanding among politicians, government water managing organizations, and water users was too limited to address all WUA issues in a comprehensive manner and with specific targets.

In 1997, the government, through Resolution #473, intended to transfer on-farm water infrastructure to the WUAs, and the land ownership and land rights of individuals. This resolution did not provide any guidance on how the WUAs would be established as organizations, their responsibilities, and links with other water managing organizations. Moreover, not all landowners were skilled irrigators, and needed guidance to organize themselves into functional WUAs and irrigation and agricultural business advice. The current government policy is that water users should take care of the canals they use.

Workshops have been held in area where there would be rehabilitation by the international finance organizations. In addition, a law was passed in 2002 that is an instrument for the legal basis of WUAs' existence, giving the right to be established as non-commercial entities for purpose of operation and maintaining specific irrigation system. The law also addresses the formation of a dispute resolution commission within the WUA and allows for a higher appeal (at the court level) of its decisions.

## Government Plans

The Government did show some commitment to supporting irrigated agriculture by assigning staff to help the WUA at the level of *oblast* and *raions*, but more effort and training is needed. Thus the supporting legal and regulatory framework for WUAs is more advanced than in other CAR countries. The government has plans under the Agrarian Policy to 2010 to successfully implement the project funded by ADB and WB, primarily related to components of WUA establishment and development.

A new draft of the water code for consideration by the government this summer makes relatively sweeping proposals for moving the water management to a river basin management concept. As such, the draft code considers re-formulating institutional responsibilities and making the new water management organizations fully operational. Under this draft, the Government is considering simpler organizational setup National Council, basin boards - participation of users, thus clearer coordinating mechanisms. An agency for policy at the top would be composed of heads of relevant ministries and chaired by the vice-minister. Water resources management would be planned on hydrographic boundaries, but the O&M will remain decentralized. The draft law also proposes differentiation of tariffs for water deliveries by basins.

The need to focus on the country water strategy is related to the interstate agreement<sup>3</sup> among the five states of the Aral Sea Basin. Primarily, the strategy is an attempt to develop a vision for the long-term and designate priorities for the irrigation sub-sector. From this it is clear that Kyrgyzstan has demonstrated political will towards reforms and the outcome is a plan for considerable transfer of responsibilities for irrigation management to WUAs, and other institutional framework changes.

## Water Pricing

Shortly after starting with reforms for land privatization, attempting to fill the gap in funding the new inter-farm network maintenance, the government temporarily assigned the responsibility for the on-farm O&M to the village governments until new organizations at the farmers' level were formed. The local governments were to collect land taxes from farmers and apply a portion to the repair of the network. However, it seemed that no money found its way back into the system. In regard to the inter-farm canals, the responsibility for O&M had been assigned to the *raion* departments operating in the field. These units had a capable staff, but almost no funds to perform this task.

Although water charge (volume-based) has been officially established in 1995 (by presidential decree), and was differentiated by the *oblasts*, the tariffs represented only about 15 percent of the real cost. Additional costs could have been covered by the land tax (by hectare). Unfortunately little money was being collected from water users because the farmers were unable to pay the fees. Most payments were in kind, therefore minimum maintenance was being done and system fell into more disrepair. Naturally, the O&M costs are central to this issue. This is important

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<sup>3</sup> In 1992 the Interstate Commission for Water Coordination (ICWC) was established and as the main task has to develop water resources management strategy in the Basin and coordinate water management policies.

information that should be provided to water users, as they—as members of WUAs—need to maintain the on-farm canals and possibly inter-farm canals in the future.

It has been estimated that the real cost for the O&M of the on-farm network is about US\$10/ha (estimate by J. Beeny, On-farm Irrigation Rehabilitation Project, 1999). Regarding the inter-farm canals, the estimated value of the real cost would be about US\$15/ha (J. Beeny, 1999), but only \$4-5/ha (DWR, 1999) is spent.

## Organization of Water Management

A remnant from the former regime, many organizations and entities are involved in different aspects of managing the water resources in the republic. At the national level, besides the Ministry of Agriculture and Water Resources (MOAWR), they are: Ministry of Environmental Protection; State Agency of Hydro-meteorology; State Committee of Geology; State Entity for Energy (accounting for irrigation interest); Kyrgyz Design Institute for Water Management; Institute for Hydro-automation; and the Research Institute for Irrigation.

Until the breakdown of the FSU, most releases from Toktogul reservoir were in the summer, providing irrigation for the downstream states, Uzbekistan and Kazakhstan. In return, Kyrgyzstan received gas, coal, and oil for production energy in the winter. With independence, each state started to guard and compete for resources.

Within the MOAWR, the Department of Water Resources (DWR), formerly the Ministry of Water Economy, carries the principal responsibility for regulating irrigation at the national level, and has a financial and institutional autonomy. Having a regulatory responsibility, the DWR sets the water consumption standards and limits and annually submits proposals on tariffs for water supply service to the government<sup>4</sup>. The aim of the DWR is mainly planning and financing of water development and management measures, land reclamation, rehabilitation of structures, introduction of advanced technologies and other improvements for efficient water management. The DWR is gradually divesting the operational responsibility and becoming more of a planning and policy body, with decentralized O&M responsibilities. The administrative hierarchy (national, *oblast*, inter-*raion* and *raion*) may be changing with passing of the new water code.

At the moment, the structure remains; at the *oblast* level there are six *oblast* basin departments (OBDs) formed as of January 1, 1997. The OBDs keep accounting of water use, issue licenses for use of water control structures, conclude standard contracts for water supply via inter-*raion* canals, and plan water allocation within the *oblast*. The OBDs control the *raion* water departments (*raivodhozes*) that are directly responsible for the operation of irrigation systems at the district level within four or five districts, depending on a particular situation. At the inter-*raion* level, there are two inter-*raion* water management organizations (UMRK) in Chui and Talas *oblasts*, subordinated to the respective OBDs, and one organization for management of reservoirs and magistral canals, subordinated to Osh OBD. In addition, there are three directorates for reservoirs Orto-Tokol, Kirov, and Papan, subordinated to the national DWR.

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<sup>4</sup> In the newly propose basin management for Naryn, Batken and Osh oblast as basins, a basin council with participation of relevant agencies and water users should be the one for approving water tariffs.



According to the legal framework, *raivodhozes* enter into a contractual relationship with the water users, be it a physical or legal entity. At the district level, the local government - *akims* - also have input into water decision-making.

## Water Users Associations

The government had realized the benefits of establishing WUAs as caretakers of the on-farm network. The formation of WUAs, with principal tasks of the O&M and distribution of water to their members, was also seen as greatly simplifying the contractual relationship for the *raivodhoz*—with a WUA rather than a large number of small farmers as water buyer—and collecting the water charges. As there was no precedent for WUAs, the beginning was slow. The government could not offer farmers any incentives to become members of WUAs, and farmers were distrustful. They also desired some assurances for these new collective arrangements, concerning legal issues and land ownership of canals (after the land privatization law was passed).

As of November 1, 1999, there were 77 WUAs established covering 131,823 ha (about 12.5 percent of the total irrigated areas), as in Table 2 below. About 53 percent of these WUAs are in the Osh Oblast. The NRMP is supporting development of one WUA in the Osh Oblast, and the *oblvodhoz* reported that it is developing successfully (due to two other missions visiting, we were not able to meet that WUA).

**Table 2: Water Users Associations**

<i>Oblast</i>	Irrigated area (ha)	Number of registered WUAs	Irrigated area within the registered WUAs
Osh	181,538	41	67,485
Jalalabad	129,140	18	29,345
Issyk-Kul	168,845	7	11,418
Chui	329,000	6	13,791
Talas	113,739	4	7,473
Naryn	127,448	1	2,113
<b>TOTAL</b>	<b>1,049,710</b>	<b>77</b>	<b>131,823</b>

Source: PPU, The World Bank On-farm Irrigation Rehabilitation Project, 1999.

## Irrigation Management Transfer

The MOAWR reports that 300 WUA are established, covering about 450,000 ha of irrigated land, or 40 percent of the total irrigated area, but only about 50 are functioning well. The objective is to establish about 500 WUA by the year 2010 and encompass all of the irrigated land by these associations. This target corresponds to the Agrarian Policy Concept for the Republic till 2010, which also focuses on improvement of conditions and use of the irrigation infrastructure.

Much of the development work on WUAs and institutional management training is externally funded—primarily two projects by the WB and one ADB. At the moment this training is confined to on-farm systems, while associations are still being formed, with the possibility of transfer of inter-farm responsibilities from *Vodkhozes* to large WUAs. The WUAs unite small family farms and other forms of farm types so that an association can enter into a contractual relationship for water as a primary activity, obtain a water permit and reduce the volume of administrative tasks of the state water provider.

## WUA Financial Management

The WUA must set up a system for collection of all water fees and charges (license, insurance fund, etc.), membership fee (if any), and charges for asset management. The General Assembly decides to levy the actual amounts. The budget, including expenditure for planned repairs, is proposed by the WUA Council and approved at the annual meeting of the Assembly. WUA should pay according to the WUA Charter, as approved by the Assembly. Water users should be encouraged to contribute labor to the routine maintenance.

All registered WUAs have their own bank account. The water fees were collected this year in some WUAs, but with varying degrees of success. Summary of these data is not available; however, individual *raivodhozes* keep records. The problems encountered will be described in the final report.

It is in the government's interest to provide incentives to farmers to join into WUAs. The incentives can be at best be expressed in some monetary value, either being cheaper water tariff for the initial years of the WUA functioning, or a reduction of some type of taxes or lower interest rates.

## WUA relationship with other organizations

With *raivodhozes* the WUA's relationship is a business-type, buyer vs. seller, on a contractual basis. Each WUA (or any other water user) should annually enter into a contract for purchase of bulk water with the *raion* department of water resources. The contract specifies the total cost based on the water fees established by the Kyrgyz parliament. The amount of water requested is based on the needs of the cropping pattern, and must be approved by the General Assembly of the WUA. The requested amount of water should be timely submitted to the respective *raivodkhoz*, so that the *raivodkhoz* can compile all water needs and can prepare a schedule of water supply deliveries.

Internal contracts between the WUA and the member are made as permanent records of water use. Charges for water are billed and collected at the end of the season; no portion of the fee is requested before water is delivered. Penalties for damage can be applied. The new draft law for WUAs specifies most operational and organizational aspects, but needs a good review and comparison with actual records so that it fits into the socio-cultural context of Kyrgyzstan and builds on the strong aspects.

WUAs may, according to the law, enter into an agreement with a non-member water user. WUAs' relationships with other entities or governmental agencies are based on the existing regulatory and legal framework and policies. WUAs interact with local administration, environment and land management agencies, and tax authorities to address the necessary water and land issues. At present, the coordination or exchange of information amongst WUAs does not exist, but, it is expected that with continued development and additional WUAs establishment, this will be formally addressed.

## Externally Funded Projects

The government had gradually built up capacity for promulgation of WUAs, and this process still continues. The development of understanding the concept, functions, and principles of operation of WUAs came with several projects funded by ADB and WB, which support their creation, and provide funds for workshops and training of water users and staff of the water departments. The projects are also tackling other water management issues, based on vision of improvements by the Government<sup>5</sup>.

The ADB initially funded a TA for awareness towards WUAs (1996-97) and came with a rehabilitation project called Agriculture Area Development project for Chui *Oblast* in 2000. The project has four components, from which the drainage component contains irrigation and drainage rehabilitation. The associated civil works on water irrigation canals affect a large areas of on-farm and off-farm (55,000 and 24,000 ha). Also, 25 percent of works on-farm will be repaid by WUAs, with two years grace period after the rehabilitation is finished. The project is testing some technologies on a pilot basis: sprinkler and drip irrigation, land leveling, shallow drainage technology, tube wells and on-farm irrigation software.

At the same time, the WB has taken a three-prong approach—Irrigation and Drainage (I/D) Rehabilitation, On-Farm Improvements, and Flood Emergency Relief. The on-farm project (2000-2006) is designed to increase agricultural production by providing a stable and reliable water supply. The rehabilitation is to affect 160,000 ha; indicators are: i) creation and development of viable WUAs capable of taking over on-farm water management; ii) physical rehabilitation of on-farm irrigation infrastructure, assuring water supply on 160,000 ha.

The total amount of the project is \$29 million, with \$20 million as credit, \$6.3 million government contribution, and \$2.7 million repaid by beneficiaries. The I/D rehabilitation project will ask for 25 percent of repayment by beneficiaries, but within seven years, so there would be a three-year grace period.

ADB, WB, and USAID have supported the development of the land and water regulatory and legal framework and national plan for changing agricultural policies and preparing water strategy. In addition, Kyrgyzstan has a pilot WUA area in Osh under the SDC-funded Fergana Valley project for IWRM.

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<sup>5</sup> The international community has not fully recognized the problems that would overwhelm the countries of the CIS after the collapse of Soviet Union. Rather than teaming up and preparing a uniform and comprehensive analysis and a long-term strategy for water resources management and the irrigation sub-sector, they developed their own approach tailored to their understanding and perceived priorities. This is somewhat reflected in irrigation and drainage sub-sector in the Kyrgyz Republic and gradually changing - ADB and WB have adapted similar approach to formation of WUAs.

## Water Management Issues and Needs

The dilapidated infrastructure is being rehabilitated in some areas by the externally funded projects. Government has limited funds for O&M and prefers to transfer it to beneficiaries. The problematic factors affecting the process of WUAs establishment their development and IMT, as well as water and land productivity are seen as:

- Physical and technical factors:
  - Systems were designed for different land ownership form and large fields of monoculture
  - Infrastructure suffered deferral of maintenance.
  - Lack of water measuring devices to individual farms.<sup>6</sup>
  - Inequity in water supply/distribution to tail-enders—need for small equipment for WUAs to be able to help themselves to measure water to tail-enders<sup>7</sup>
- Few or no water measurement devices in the WUA's territory, thus water cannot be measured internally and can only be estimated. (In some cases, the canal turnouts or dividing structures are calibrated.)
- Inadequate structures and inaccurate measuring (or estimation) is a prime cause for disputes between the WUAs and *raivodkhoz*. Need for measuring structures at the turnout of canals of disputes among water users, and disputes between the Council, water masters and the users; also need mediation training.
- Water delivery may have political agendas vs. legal framework. Farmers and WUAs do not know their rights—they need explanation and training.
- Social and economic factors:
  - Traditional attitude of farmers to water as a free resource
  - General lack of trust of government actions and need for more methodical and patient promotional effort

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<sup>6</sup> The effort was made to establish WUA as legal entities within the boundary of the former kolkhozes or sovkhoses. These former farms covered areas from 500 – 3000 ha, and received water from different sources, such as magistral, raion and inter-farm canals, as well as natural water bodies. Hydroposts were installed at the water intakes to the farms to measure the amounts of water used by the farms. Some of the new WUAs that are established within the boundaries of the former large farms have retained the ability to measure water at the intakes from the sources. The size of these WUAs is in a range from 1500 – 2500 ha.

<sup>7</sup> Water is distributed between farmers according to a waiting list based on the cropping pattern and irrigation requirement and in many cases distributed by water masters –mirabs- previously employed by the former large farms (rent seeking possible).

- Resistance to change the top-down approach of the water management organizations. More awareness and information needed countrywide, like making videos of successful WUAs, Republican roundtables seminars, study tours, etc.
- Need for start-up funds for WUAs to buy office furniture, filing cabinet, computer, chairs for meetings, video camera, overhead projector, black board, pens, paper, notebooks, etc., so that they can do in-house trainings<sup>8</sup> on matters concerning WUA financial administration, O&M needs and plans, rights of WUAs members and their obligations towards WUA, water distribution questions and engineering improvements, plans for cropping and water supply.

## **B1g. Associations**

The government provides directives for industry and agriculture through industry and trade associations that coordinate and facilitate enterprise and farm activities. Membership to associations is voluntary in principle but access to scarce resources is dependent on associations. Associations are typically a monopoly for centralized marketing of enterprise output. Small farmers and SMEs may be members of industry and farmer associations but also operate outside of government monitoring functioning in the cash based transactions economy outside the government control.

The companies law does provide for organization and registration of private association as joint stock companies or as nongovernmental organization. Association incorporators must carefully determine what functions they expect the association to fulfill before determining which organizational form to use. Non-profit associations and NGOs are non-taxable but they are also restricted in the types of activities that the registered NGO can undertake. Nor is it clear whether an NGO can convert to a profit oriented joint stock company if the membership later decides that it wants to expand into some commercial activities on behalf of members.

## **B1h. Summary of key issues**

Agricultural production issues:

- Agronomic practices and farm management
- Land ownership and use rights
- Access to inputs and appropriate technology
- Access to finance
- Membership organizations
- Market linkages.

Water management issues:

- Incomplete legal and regulatory framework

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<sup>8</sup> To bring up the level of understanding of the WUAs' role, tasks, rights, and responsibilities, as well as rights and duties of their members, training centre for WUAs under the WB project was set up, but as it is in the capital Bishkek, not many farmers can readily access it.

- Need for targeted water user association (WUAs) development
- Capacity of water managers (state and WUAs)
- Pricing policy and cost recovery
- Functional infrastructure and distribution technology
- On-farm water measuring devices.

Agro-processing issues:

- Business and resource management
- Access to quantity and quality raw materials
- Access to supplies and equipment
- Access to finance
- Membership organizations
- Market linkages.

Allied industry issues:

- Input supplies
- Private ownership
- Increased services
- Water department services
- Water delivery (quantity and timeliness)
- Mechanization units
- Private ownership
- Appropriate technology
- Leasing options
- Consulting services
- Legal and tax advice.

Financial service issues

- Trust between businesses and creditors
- Borrower financial management creditors
- Lender understanding of producer and agro-industries
- Limited borrower assets
- Government policies.

Market and market intermediary issues:

- Insufficient market intelligence
- Trade linkages
- Transportation, security, and storage
- Market infrastructure
- Local assemblers – working capital and transport
- Wholesalers – regular supply volume and quality
- Retailers – packaging, labeling, price.

Enabling environment issues:

- Legal rights awareness
- Land, water, and commercial

- Conflict mediation and arbitration
- Tax reform
- Commercial legal regime
- Cross border trade barriers
- Policy formation mechanisms.

## **B2. Examination of Donor Programs**

USAID programs in Kyrgyzstan have largely focused on private sector development issues. The brief program summaries provided below are not intended to be exhaustive but reflect USAID program activities of organizations as those programs relate to agriculture and water. Given the fact that agriculture is such a dominant part of the economy and rural employment and water is so tied to healthy living as well as agricultural production, most donor projects in Kyrgyzstan have been touched in some way by these sectors.

### **B2a. USAID/CAR projects**

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#### **ACDI/VOCA Country Representative Office**

*Bai Tushum Financial Foundation/Microfinance Program*

*Muhammed Junaid. Country Representative/Bank Advisor to*

*Gulnara Shamshieva, General Manager, Bai Tushum*

Bai Tushum<sup>9</sup> Financial Foundation was established by ACDI/VOCA and the Swiss CARITAS to provide microfinance services in selected Kyrgyz communities. Bai Tushum's financial and administrative support from USAID ends in September 2004 and not likely to be extended. The history and major features of the Bai Tushum and its financial program are as follows:

- ACDI/VOCA established four microfinance facilities in 1997 in the Chui, Osh, and Jalalabad *Oblasts* focused on agricultural production financing from the proceeds of a USDA monetization of vegetable oil.
- Bai Tushum is the first MFI fully registered as a formal financial institution with the Ministry of Justice under the new Kyrgyz Law on Microfinance.
- Bai Tushum is a fully sustainable MFI with \$2 million in total assets consisting of a loan portfolio of \$1.4 million and \$0.6 million in capital.
- Bai Tushum has been thoroughly audited in 2002 under the microfinance guidelines established by CGAP as the strongest MFI in the Central Asia region.
- The repayment experience of the initial loans was low, requiring restructuring of the Bai Tushum Foundation with a refocus of financial products on microenterprise and entrepreneurs.

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<sup>9</sup> Bai Tushum means prosperity in Kyrgyz.

- Current loans are targeted to crop production (fruits, vegetables, and vineyards), livestock (poultry, meat and milk production, cattle operations), agroindustrial and food processing, tourism and hospitality, and retail trading.
- Customers must be Kyrgyz residents, registered Kyrgyz businesses, have one year of operations, and have a minimum of 25 percent equity to support the business venture.
- Loans to individuals and legal entities (no solidarity groups) are up to 18 months for livestock production and one year or less for all other loans. Loan sizes range from \$400 to \$20,000 with the average loan size of \$1,500.
- Interest rates are 35 to 40 percent for first time borrowers declining to 28 percent for long term borrowers. The all-in financing cost is about two to three percent per month based on application to the declining balance. All loans are denominated in sums.
- Bai Tushum sees only KFC as its major competitor, largely due to KFCs subsidized rates<sup>10</sup>.
- All first time Bai Tushum borrowers go through an extensive training process.
- Approximately 25 percent of Bai Tushum's loan portfolio is devoted to agricultural production or crop loans; 32 to 35 percent are involved in livestock production—beef, pigs, and sheep with an average term of 11 months and up to 18 months for the best customers; about 40 percent of loans are in SME production, processing and trading, including handicrafts, computers and computer services, saunas, food service, restaurants, bakeries with terms of 6 to 12 months. Thirty five percent of agricultural production and livestock loans are to women and 55 percent of SME entrepreneurs are women.
- Bai Tushum conducts an open house every quarter to market its loan products, meet with borrowers and discuss application or loan administration problems, and meet with new prospective borrowers.
- Bai Tushum is currently talking with the IFC about developing leasing operations for tractors, harvesters, and other farm production equipment.
- Bai Tushum currently operates in Kara-Suu, Aravan, and Nookat raions of Osh Oblast, Jalalabad, Chui, and Bishkek.

## Recommendations:

1. WUAs need organizational and administrative support to develop a fully functioning association. Many borrowers are having problems obtaining water due to breaks in the

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<sup>10</sup> KFC maintains that their rates are not subsidized, but they received their loan funds from the World Bank/IDA loan. Bai Tushum receives its capital as a grant from monetization of commodities from USDA.



system or disagreements among neighboring producers. MFIs would prefer that a fully operational association charge appropriate rates to have the system repaired and maintained to reduce the risk of producer borrowers not receiving water timely.

2. The land reform process must be streamlined to speed up landowners receiving certificates to enable pledging of land.
3. Mortgaging should be made universal and reformed in several respects. Currently, only financial institutions having a full banking license may take a mortgage. In addition, it is currently impossible to foreclose on a mortgage. The lender must prove the debt is close to the value of the land or a court will nullify it.
4. More attention in Kyrgyzstan must be paid to agroprocessing, marketing, and storage facilities. The Kyrgyz Republic has few quality agro and food processors for producers to market their products and consistently receive a reasonable price. Market channels are non-existent in Kyrgyzstan, especially with the strong potential market in Kazakhstan due to border closings, customs duties, and transport costs, limiting a producer harvest value to sale in the bazaar and a few agro and food processors. Consequently, tomatoes are almost free at harvest time.

## Foundation for International Community Assistance (FINCA) Microfinance Program

*Jason Meikle, Executive Director*

*Cholpon Duisheeva, Regional Manager/Osh*

FINCA (Foundation for International Community Assistance), with over 20,000 clients in all *oblasts*, is the premier microlending institution in Kyrgyzstan. FINCA's microcredit project, financed by USAID, provides small loans, a savings program, and technical support for the self-employed poor. FINCA believes women, 86 percent of loan recipients, are the cornerstone of the family, and helping them grow their businesses is an effective weapon against poverty. Since operations began in April 1995, FINCA has disbursed over \$53 million to clients with a repayment rate of 99 percent. By offering small loans, (average starting size of \$294), FINCA focuses on low-income families who have little access to other means of credit.

Savings and Credit Groups, or Village Banks, are the primary mechanisms for FINCA's micro-credit lending efforts. Village banks, composed of 5-20 members, operate as mutual support groups to facilitate the disbursement of credit, repayment of loans, and management of group savings. Groups meet weekly over the course of a four-month cycle to make loan repayment and contributions to savings. Group savings, or the internal account, is perhaps the most remarkable aspect of the FINCA program. Group members are compelled to save 10 percent of the loan amount in the group's internal account. These savings are controlled by the group and can be used to invest in individual businesses or for consumption, but the majority is lent within the group and acts as a second source of capital, yielding interest on short-term loans to other group

members. To date, FINCA clients have saved over \$157,487. As bank members grow their savings they qualify for larger loans, effectively linking savings to the growth of their businesses.

### **Key points:**

- FINCA extends both group and individual loans.
- The MFI has total assets of \$6 million with an outstanding loan portfolio is \$4.3 million.
- The MFI is sustainable and no longer receives donor support.
- The MFI is in the process of converting to a commercial for profit MFI under the new Law on MicroFinance and expects full registration by June 2003.
  - Full taxation will begin as a financial institution;
  - Payment of social security and other service taxes and fees are applicable.
- FINCA currently owns 100 percent of the MFI but the IFC will be investing approximately \$160,000
- The MFI can place any funds that it has available for lending but the microlending market has flattened and becoming saturated. Competition is beginning in some areas with donors trying to cherry pick each other's best clients.
- FINCA has been in Kyrgyzstan the longest and has the most extensive branch network of any MFI with five region branches and seven satellites.
- After becoming a formalized regulated financial institution, the FINCA operation will start to go into SME lending and larger loans.

The microloan products are village group lending loans and SME loans to individuals according to the following terms and conditions:

- Group lending loans are extended for four months and range from \$30 to \$1,000 depending upon the size of the group and the number of loans that members of the group have previously taken and repaid. No collateral is required for group loans.
- Individual loans are extended for up to six months and from \$400 to \$10,000 depending on the borrower's business, credit history, loan repayment history, and available collateral for pledging.
- MFI does not believe that it can realize a high percentage of the collateral pledged due to the lengthy judicial process and corrupt judges, but MFI takes the collateral anyway to make the borrower believe that it will be able to recover it.

- Loans are extended in primarily urban and rural urban areas to trade, service businesses, and production. Loans are extended to market traders in fruits, vegetables, meats and milk; to restaurants and food service businesses; to milling of grain and oilseed pressing and processing; and to bakeries. The MFI is beginning to venture more into agricultural production including livestock production and poultry and egg laying productions.
- Loan rates range from three to four percent per month with late payment penalties
- The MFI's loan repayment rate varies between 98 percent and 99 percent.

### Helvetas/ Kyrgyzstan Swiss Association for International Cooperation and USAID Legal Assistance to Rural Citizens (LARC)

*Lamar Cravens, Technical Advisor*

The Legal Assistance to Rural Citizens project was begun in the Jalalabad *Oblast* in 2000 by the Swiss NGO Helvetas under the donor support of the Swiss Agency for Development and Cooperation (SADC) for land reform legal assistance and good governance. USAID began supporting LARC during its second phase (2002-2004), which expanded the mandate to provide services to rural citizens enabling them to be gainfully employed in agricultural production, SME processing and marketing, full realization of land rights, and the promotion of peaceful society operating according to laws. LARC sought to augment the national capacity of decision-makers and legal professionals to apply the law accurately, consistently, and impartially. Some special features of the LARC program:

- A national legal assistance center organized and incorporated in the Kyrgyz Republic and consisting of a network of 21 service centers located in the Jalalabad, Osh, Batken, Naryn, Issyk Kul, Talas, and Chui *Oblasts* staffed by 50 LARC trained local lawyers to provide legal assistance to rural citizens. Ten centers in the north and 11 in the south of Kyrgyzstan.
- LARC is a decentralized client driven rural legal advisory services operation providing services primarily to rural poor. Ninety percent of the cases involved problems and disputes with local government officials.
- LARC currently receives donor assistance from USAID and Helvetas but believes that a potential for becoming self-sustaining is possible.
- A national and international support network of government ministries, NGOs and international organizations, including MOAWR, ARD/Cheechi Commercial Law Project, Chemonics Legal Agrarian Reform Project, ABA CEELI, Attorneys' Association of Kyrgyzstan, Kyrgyz Young Lawyers Association
- LARC had provided rural legal services to more than 7,000 clients during the past year; more than 80 percent were Kyrgyz and 75 percent were male.

- LARC clients are typical poorer residents that are financially unable to pay officials to achieve the desired results. LARC charges all clients fees for services though most do not pay the full cost of the services provided.
- LARC has instituted more than 30 suits against local officials achieving favorable resolutions for its clients despite the corrupt judicial system.
- LARC casework and legal assistance to rural residents nationwide has generated a substantial database of the economic and social problems and their solutions. The types of information that the LARC database may provide include without limitation:
  - Information on water rights and delivery issues based on the water disputes involving interference by local officials, upstream appropriation of water, refusal of local or national governments to repair primary or secondary canals.
  - As most legal services involve land issues, much information is available in the LARC database on the average size, location, distribution and other characteristics about land.
  - The number and types of disputes involving local officials abusing legal and water rights and methods of abuse.
  - The number of women denied property settlements in divorce.
  - The most commonly misunderstand or disputed aspects of land lease or water rights of rural residents.

The primary services that LARC provides are as follows:

- Information: Legal information of a general nature to individuals or groups on selected broad legal topics and tailored to the needs of the group—farmers, decision-makers, judges, etc.
- Consultation: Preparing documentation or mediating actual disputes. LARC has advised more than 7,000 clients and consultation constitutes the bulk of LARC's program services.
- Representation: Representation of a citizen against another citizen or governmental agency whether before administrative or judicial bodies.

## **Recommendations**

1. LARC database should be thoroughly examined for information that could be used to support reform in nearly every aspect of the economy.

2. Support a system of certifying mediators to gain trained impartial professionals able to assess the positions of opposing parties and develop consensual compromise that furthers commerce and local peace.
3. LARC believes that further training of judges is a waste of resources until the government makes a serious effort to attack the pervasive corruption.

## MASHAV/USAID Advisory Center on AgriBusiness

*Julia Vyboichenko, Country Manager*

MASHAV Bishkek has a staff of four that includes crop and livestock specialists. The primary activities in Kyrgyzstan are pilot demonstration projects for dairy and drip irrigation. They also conduct training activities in Kyrgyzstan and Israel.

### **Key points:**

- MASHAV provides opportunities to improve skills in training courses and seminars. In the last four years over 500 participants have been trained in Israel and about 30 seminars conducted in Kyrgyzstan.
- MSHEV designed and implemented pilot demonstration projects that included a mini milk processing plant with a 2,000 liter capacity per shift in Chui region, drip irrigation, milking parlors, and aqua-culture.
- Consulting centers are maintained in Bishkek, Osh, and Cholpan-Ata regions that provide advisory services and develop innovative projects. Veterinary services are also provided.
- Producers and processors are interested in new equipment that is demonstrated at the pilot sites along with information on the use of the equipment.
- There is a serious problem with the assembly of raw milk for the producers and processors. The processors operate at very low capacity because of transport and assembly problems. There are very few collection sites with cold storage tanks and about 80 tons of raw milk supplied to processors in Bishkek each day.
- One Bishkek dairy processor collects from a 40 km area and has invested in holding tanks in many villages. They also have their own production facilities.
- The problem is that there is no processing in the rural areas.
- The pilot milk parlors want to start their own collection. Demand for raw milk seems to be low and seasonal, and thus they are considering cheese processing.

- Meat processing is still in urban areas and not working very well. Kyrgyzstan used to be the primary producer of mutton to Russia. The industry fell apart over the last ten years, but could have a promising future. Livestock has always been a part of Kyrgyz tradition.
- Marketing of meat is a problem because processors don't conform to international standards. The Swiss will help the government equip laboratories for inspection services so they can certify products for export. Most skins are processed in Bishkek and exported to China through traders.
- The opportunities in agriculture are in fruit and vegetables, especially drying of high quality fruits (apricots and raisins) and vegetables (onions and tomatoes) for export.
- Land issues include leasing of land for longer periods of time and the Land Fund shares to be disposed of by local authorities.
- In terms of agricultural extension services, the Rural Advisory Departments (RADs) have been largely invisible to small rural producers.

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### Bishkek - Pragma, Trade & Investment Project

*Kelly Seibold, Project Director*

*Bruce Wilson, Country Representative/Regional Marketing Advisor*

*Kathleen Dunkle, Director, Business Advisory Services and Osh Agribusiness Initiative*

The Pragma EDP and TIP projects in CAR are well known and their mandates do not need to be clarified further in this document. The services they provide through their network of regional and sub-regional offices are quite extensive as is the quality of their personnel.

### **Key points:**

The leaders of these projects walked us through their services and activities, which have been described elsewhere. Additional comments are noted here.

- TIP activities are deeply involved in regulatory reform issues regarding removal of investment constraints and as well as cross-border trade facilitation. The project is not working on institution building per se, rather focusing on resolving constraints.
- Work is conducted at the firm level and with groupings of similar firms.
- Customs activity includes removing barriers, transit issues, and procedures. Work on reforming the system of standards, including the legislative base, is ongoing
- The project could use some assistance in the area of WTO Sanitary and Phyto-sanitary (SPS) and Technical Barriers to Trade (TBT) agreements, in terms of targeted technical assistance to the government in these areas that relate to agriculture and food products.

- Regarding agribusiness clients, the gaps in the existing projects would include on-farm assistance. The project can provide farmer management, marketing, and access to finance advisory services. Farmers participate as members of technical working groups and access the winter management course series.
- Regarding project activities in Osh – they are the same services provided elsewhere only with a roster of clients focused on agribusinesses
- There are many fruit and vegetable clients; they would like to see more clients from the livestock industries.
- The Osh Agribusiness Initiative has found the major constraint for processors is the absence of funding for working capital.
- The Osh office is working with communities on solar drier activities.
- Water does not seem to be an issue for clients.
- The Osh cotton association is very strong.

## OSH - Pragma, Trade & Investment and Enterprise Development projects

*Stephanos Orestis, Ferghana Valley Program Director - TIP*

*Richard Tracy, Deputy Director, Business Advisory Services*

*Philip Mowbray, Agribusiness Specialist*

*Edilbek Konurbaev, Business and Trade Advisor*

*Buajar Abdykadyrova, Business Advisor*

*Kenje Primova, Business Advisor*

Pragma managers explained that the Osh Agribusiness Initiative (OAI) was developed by AID, at the suggestion of the governor, in order to help the agribusinesses in Osh realize their full potential. The memorandum of understanding signed by these two parties states that assistance would be provided to establish agro-processing as the principal contributor of economic growth and employment. The assistance would concentrate on identification and development of markets for processed agricultural goods. Cooperation would also focus on increasing investment and improving the business and investment environment.

### Key points:

- EDP/TIP advisors will focus client services on processors and feel that working with producers is also important because of the problems processors have securing sufficient quantities of raw materials of a good quality on a regular and timely basis.

- The production – processing interface is an opportunity to contribute to agricultural development. Supply contacts design, implementation, and enforcement are key to achieving results in this area.
- EDP/TIP advisors feel that the primary issue constraining processor development is a lack of adequate finance. Micro-credit programs are not adequate for most processors who need financing in the \$50 to \$250 thousand range. Processors that are looking investments in the \$1 million dollar range could make a significant impact on demand for local produce, especially for fruit and vegetables.
- Coordination with other AID and other donor projects is an issue that is being resolved by AID through the Osh coordinator. Recent coordination meetings have helped. However, the problem seems to be beyond coordination and into integration of various activities. The question of how to focus different projects to achieve a higher degree of integration was raised.
- The agribusiness advisor feels strongly about focusing on producer/processor linkages as well as post-harvest technical issues.
- Suggestions included having OAI repositioned from EDP and TIP and report directly to AID. OAI can continue to deliver advisory services and training, but without a credit component, they will not have the incentive needed for producers and processors to invest in new technologies. The problem is that the advisory services are recommending investments to be made in the firms, while knowing the investment funds are not available.
- Finance from KFC in Osh is not available because they have a liquidity problem and finance from ACDI/VOCA is not appreciated because of high interest rates, poor terms, and slow processing procedures. They view these finance programs to be too conservative to meet local financial needs.
- There is a desire and need to help agro-processors with their export programs. Their market surveys have found market opportunities for large volumes of product of good quality and in appropriate packaging in Russia and other CAR countries. However there are very few firms able to satisfy these market conditions because of the problems stated above.
- The EDP and TIP project managers are working with their office managers in the Fergana Valley to facilitate trade in the Valley. Organizing work group meetings with key stakeholders and focusing on specific deals has helped push this activity forward.
- Traders, who are clients of the project, say they can do more if the payment and volume issues can be resolved.



## ARD/Checchi Commercial Legislation

*Bryan Kemple, Chief of Party*

*Douglas Myers, Deputy COP*

### Key points:

The Commercial Law Project has provided legal services for four years in drafting legislation and regulations; training lawyers or judges on commercial law, bankruptcy, civil and criminal procedure; judicial administration; and in providing a vehicle through which legal and economic reform issues could be developed. Major points and recommendations of the Commercial Law Project include:

- Powerful interests do not want to reform the judiciary as they are able to purchase decisions needed to further their interests. Impact of corrupt judiciary felt throughout the economy.
- Civil Code reforms adopted in 1996 based on the Dutch Civil Code and considered good modern commercial law.
- Banking laws are adequate, though reform remains, but the NBKR is hampered and ineffective, unable to enforce regulatory or administrative actions in the courts because more powerful interests are able to prevail with the judiciary.
- Commercial arbitration system has been developed and specially permitted by the Constitution of the Kyrgyz Republic
  - Supreme Court has decided to ignore the Constitution's commercial arbitration clause and hear commercial arbitration disputes, providing duplicate decisions at best and at worst nullifying commercial arbitration.
  - Commercial arbitration is not yet operational but may not be in light of the Supreme Court decision.
  - Leaves in doubt the enforceability of any commercial arbitral award.
- Local administrators—*hakims*—appointed by President.
- Mortgage law is not useful and no mortgage market exists
  - Only individuals may own, purchase or sell agricultural land.
  - Small agricultural plots in the south are too small to support loans sufficient for business development

- The new Pledge Law attempts to merge the Pledge and Mortgage Laws but creates new problems with each that would significantly damage real estate and business financing. A donor and Kyrgyz banking and trade association working group has commented extensively on all of the provisions of the new draft law and presented the comments to the appropriate Parliamentary committees and members. Additional discussions have taken place with appropriate government officials to impress upon them the heavy damage that the new law will cause to Kyrgyz banking and business communities.
- Trying to develop Economic Free Zones—free of taxes, regulation, and administrative practices that inhibit production and manufacturing—supported by Rotary International and International Business Council.
- Economic Policy or Investors Secretariat has played a useful role in creating a dialogue between the national and international business community and the President on needed reforms to generate business and economic growth.
  - Government implementation of issues discussed with the Secretariat has been wanting.
  - Government has ignored the Supreme Court decision on Commercial Arbitration after the international business community spent more than five years lobbying the government to adopt a commercial arbitration system to encourage foreign investment
- Land reform legislation is being considered by Parliament and may be adopted by summer of this year.

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## Bearing Point – Bank Supervision

*David Hawkins,*

### **Key points:**

Bearing Point has provided technical assistance to the NBKR for nearly three years and there has been substantial improvement in bank supervision, off-site examination, and prudential regulation. The primary weakness of the NBKR program is the ineffectiveness and corruption of the Kyrgyz judiciary in not enforcing NBKR bank supervisory actions.

Regarding the quality of banks, much remains to be done to improve the quality of corporate governance and bank management:

- Powerful Kyrgyz interests are able to forestall NBKR supervisory actions regarding interlocking directors and owners of some banks and their insider loan extensions. This will occur over time naturally as these banks go bankrupt as a result of their poor banking practices.

- Banks are doing their own accounting without auditing, review, or advice from independent accountants. This practice will change over time as the Kyrgyz Republic meets its commitment to adopt IAS.
- Traditional bank placement of funds with international money center operations for reasonable interest rates in hard currencies has dramatically declined in profitability due to low global interest rates and low funding demands.
- Banks need new business opportunities other than the few local corporate clients, but have not been able to develop the business.
- Bank loan officers need assistance in understanding the underlying economics and cash flows of all types of SMEs including agribusinesses as this is the available market for banking.
- General bank officer training in credit analysis, loan pricing, loan structuring of disbursements and loan payments, and collateral valuation is sorely needed.
- Bank officers are grossly overvaluing collateral because they do not factor in the high cost of trying to realize on the collateral through the corrupt judiciary and the grossly inadequate pledge law.
- The Kyrgyz pledge law and the proposed amendments do not reflect in any way the economics of lending and will only retard banking and increase corruption.

## Winrock International/Institute for Agricultural Development

### Farmer-to-Farmer Program

*Bolotbek Oruzbaev, Country Director*

*Ulan Raimbekov, Country Director Assistant*

The Kyrgyz farmer-to-farmer program, in response to the Osh agribusiness initiative, opened an office in Osh in coordinate with other donor programs on the provision of technical advisory services.

### Key points:

- Winrock has prepared scopes of work for Osh in the areas of greenhouse management, integrated pest management, confectionary business, fruit and vegetable processing, cotton seed production, fruit drying, and livestock.
- Has also provided volunteers to civil society projects in the areas of bakery development, grain storage, apple orchard management, and mushroom growing.

- They have also collaborated with the World Bank RAS centers on extension issues such as poultry and wheat production.
- Pragma, IFDC, and TACIS have facilitated the development of targeted scopes of work.

### **Recommendations:**

Focus Osh technical assistance on the fruit and vegetable industries, especially for small scale processing.

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### **Small Enterprise Assistance Fund - SEAF**

*Cholpon Kokumova, Country Representative*

SEAF is a small venture capital fund established by USAID, EBRD and other international donors for investing in SMEs in Central Asia. The largest portion of the investment portfolio is invested in Kazakhstan with smaller developments in Kyrgyzstan and investments under consideration in Uzbekistan and Tajikistan. SEAF began operating in Kyrgyzstan in the fall of 2002 and has been working to develop a pipeline of projects for investment consideration.

Comments on Kyrgyzstan private Enterprises:

- Enterprise managers are very deficient in understanding the basic information they need to operate their business and make sure that products are sold and revenues are generated. Their knowledge of markets and how they operate is limited.
- Managers are extremely suspicious of anyone seeking their financial and operational information and therefore are very opaque. Fear of taxing authorities is high. Many maintain two and three sets of financial records depending upon their needs.
- Privatization of Kyrgyz state-owned companies is complete but without positive business growth resulting from the new managers.
  - Most privatizations involved some form of management buyout where the old Soviet management remained in charge.
  - Most lack technical expertise and marketing knowledge, trying to recreate old Soviet marketing channels.
  - Rotating out old management is a slow process, occurring after economic downturns, bankruptcies, business sales.
- SEAF believes the investment climate in Kyrgyz is good with the ineffective and corrupt judiciary being the weakest area. Major areas needing attention include:

- The weak payments system requiring businesses to use cash to transact business.
- Lack of effective collateral and mortgage laws.
- Cross border customs and trade issues, particularly Kyrgyz assessment of 17 percent VAT of the value of the invoice or bill of lading at the border—effectively an export tax.
- Business financing is not as difficult for creditworthy businesses as many suggest:
  - EBRD program through KCIB and KazKommertzKyrgyzstan Bank is working well with loans available from \$50 to \$50,000 meeting bank's loan criteria.
  - Loan rates are high—from 25 to 28 percent.
- Kyrgyz Agro-industrial and food processing businesses are very weak in working capital:
  - Most manage to remain in business through barter trade with local, Russian, or Kazak buyers and promises to growers to pay after payment for the processed products.
  - The average firm has a six-month cash flow gap that they have been unable to fill from attracting additional investment to bank financing.
  - New mortgage land may enable them to privatize land but many reported flaws with the legislation make this unlikely.
- SEAF currently looking at 12 potential investments related to agrobusiness—nine in the north and three in the south.
  - Northern projects include vegetable processing, corn processing into oil and meal, dried fruits and vegetables for export to Russia and Europe.
  - Southern projects include cotton, tomato processing, and soy processing.
  - Average size investment is expected to be about \$300,000 only in equity.
  - When joint ventures are involved, long term debt can be considered.
- Many difficulties in agricultural production providing raw materials for processors:
  - Many privatized farms do not have sufficient technical expertise to produce the crops that they are attempting to grow.
  - Lack of quality seeds is high and needs long term local solution as importing is irregular.

- Agricultural producers have little collateral and thus must barter for inputs—seed, fertilizer, and CPCs—at values where the inputs supplier gains a substantial advantage.
- Inability to mortgage land crippling farmers’ access to credit.

### **Recommendation:**

- Focus PRAGMA EDP activities to give more detailed marketing information upon which a business plan of specific enterprises can be based. General marketing information is useful but investors must know product sizes, qualities, and price points
- Online trading is useful demonstration to companies on market operations but real solid market information of a wide range of SKUs would be more helpful to enterprises and investors.
- Provide managers with more training on: marketing and achieving sales of products produced; and on accounting and transparent management of the company to enable managers to have the right information to fulfill their functions.
- Provide bank loan officers with working capital lending expertise to agro-industrial and food processors.

### **Kyrgyz Agro-Input Enterprise Development Project International Fertilizer Development Center (IFDC)**

*Hiqmet Demiri, Deputy Chief of Party*

Operating since the fall of 2002, IFDC has focused on three program components centered in Osh, Kyrgyzstan. IFDC closely works with Pragma, GTZ and RAS to coordinate activities and leverage program to serve the clients and customers of other programs.

### **Association Development**

- IFDC established the independent private Agriculture Association of Kyrgyzstan as a dues paying fee for service trade association to assist farmers with product and technical information on all types of inputs—seeds, fertilizers, and CPCs.
- Works with directors to have committee and village meetings regularly to develop strong participation of directors in the organizational development of the association and perceived value of the community from the association’s services.
- Trained seven area business people in inputs supply at a USAID-supported Regional Inputs in Baku, Azerbaijan with immediate interest in tender participation in IFDC fertilizer.

- Successfully imported 100 tons of NPK fertilizer in cooperation with GTZ

### **Business Development Services**

- Fee for services to association members such as monthly newsletters on marketing and input information.
- Provide monthly tracking information on local market prices of 90 items.
- Provide loan guarantees for enterprises for production or inputs supply based on business plans.
- Revolving fund of \$20,000 used to guarantee commercial loans to borrowers supported by IFDC services.

### **Agronomic Services**

- Seed workshops introduced growers to international suppliers of seed.
- Prepared eight field demonstration projects for each southern *oblast* for 140 new varieties of vegetables, melon seed, and cotton for Kyrgyzstan.
- Special field demonstration of properly cultivated dryland wheat for harvesting in June.

### **Recommendations**

- Have a Central Asian Regional Inputs Supply Workshop in Osh for Kyrgyz, Uzbek, and Tajik entrepreneurs to become more fully aware of the opportunities and approaches for developing inputs supply in the region. Approximate cost is \$35,000.

### **ACDI/VOCA – CAIP project - Osh**

*Hugh Brown, Project Manager*

The Community Action Investment Program (CAIP) facilitates the process of joint community action to address priority social services, infrastructure, and employment needs. CAIP aims to develop long-lasting, substantive partnerships among local governments, citizens' groups, businesses, and organizations.

### **Key points:**

- Community action initiatives are implemented through a democratic approach, which includes conducting household surveys, and public meetings to learn more about community needs.

- Community projects are demand driven and usually cross-cutting in scope. To date CAIP has been investing more in social infrastructure, such as health clinics, electricity, schools, potable water, and roads.
- There is a recognized need in many communities for investments in added value food processing, such as wheat milling operations.
- The CAIP project will start to focus more on economic development activities in urban areas that may include food processing.

### **Recommendations:**

- There is a great opportunity for AID in agro-processing and water development activities in the Osh region, but not for large scale projects.
- The \$10-30,000 project in small-scale processing make a lot of sense in Osh. Such a program would require adequate training and access to credit for working capital.
- The focus of any CAIP activities in this area would be to maximize the income generation and employment creation. Those projects that would contribute the most to job creation would be given the highest priority.

### **B2b. World Bank projects**

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#### **World Bank (IDA), Kyrgyz Agribusiness and Marketing Project**

*Irina Mukambaeva, Project Coordinator*

*Arthur Russell, Farm Service and Input Specialist*

In February 2003, the World Bank conducted a preparation mission for the Agribusiness and Marketing Project (ABMP). The project size (estimated at \$15 million) is still under discussion with the Ministry of Finance. A contractor (AFC Consulting International) is providing consulting services for the preparation of the project.

#### **Key points:**

- The overall objective of ABMP is to enhance the efficiency of agricultural production, processing, and marketing to increase income and employment of the population in Kyrgyz Republic.
- Expected components of the project will include policy reform, agriculture and agro-industry services, improved access to capital, group/association development, and export promotion.



- The project preparation consultancy implemented by AFC Consultants International includes: formal presentations and discussions with the MOAWR regarding the proposal; commissioning of working groups (composed of ministry staff and outside stakeholders) in marketing, enterprise development, farm services, and input supply. The working groups discuss relevant ideas and information collected from existing projects, and provide guidance for the consultants. The output of this consultancy will be a project implementation plan.
- The AFC consultants are recommending a supply chain model approach that focuses on identified gaps and weaknesses. They are also looking at value-added processing and the possibility of introducing new products.
- The AFC team will conduct detailed supply chain analysis of the following products: cotton, potatoes, soybeans, tomatoes, apples, and mutton.
- The project implementation plan is expected to be completed by June and discussions will begin in July 2003.
- There is little understanding of how to manage an enterprise under a market economy. For example, strategic planning and operational efficiency are not utilized or understood. There also seems to be a lack of entrepreneurship required to implement new agribusinesses to replace the old and failed state agro-industries.
- Groups, associations, and cooperatives are important for creating market-responsive structures that serve to link production, processing, and markets.
- The essential challenge for the government is to create a sound enabling environment that facilitates private enterprises to operate and develop.
- The AFC team will identify specific regulatory changes to improve the competitiveness of Kyrgyz commodities based on supply chain analysis.
- The AFC team will specify the types of services to be provided under the project and how they will be provided. They will consider a new approach to contracting with private service providers; the possibility of a competitive grants program for supporting new technologies and approaches should be included.
- Regarding improved access to capital, the consultants will recommend a prospective scope and size of a line of credit to address investment needs. This will be based on the supply chain analysis consistent with project objectives.
- The World Bank initiated the Agricultural Support Services Project (ASSP) in 1998 and may extend certain components of the project to dovetail with the proposed ABMP. The ASSP objectives are to improve the incentive framework for, and productivity, profitability, and sustainability of Kyrgyz agriculture by: assisting the government in

implementing land and agrarian reforms; providing emerging private farms with advisory and development services; developing the seed industry; establishing a legal framework, organizations and procedures for crop protection and plant quarantine; establishing an agricultural market information system; and enhancing the institutional capacity of MAWR.

- The ASSP is comprised of the following main components: (i) Land and Agrarian Reform (Support to Farm Restructuring); (ii) Rural Advisory and Development Services (RADS); (iii) Seed Industry Development (for cereal and fodder crops); (iv) Crop Protection and Plant Quarantine; (v) Agricultural Market Information System; and (vi) Institutional Capacity Building of MOAWR, including of the Project Implementation Unit (PIU), already established, to ensure timely implementation of the above components, consistent with sound financial, economic and technical standards.
- The AFC consultants felt that KAMIS has not been able to diffuse important information as broadly as needed. For example, they only produce 600 issues per week through paid subscriptions. They would also like to see a wider distribution of the new publication, *AgroPress*.

## **B2c. Asian Development Bank projects**

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### **ADB – Agriculture Area Development Project**

*Peter Goodman, Team Leader, Farm Management Specialist*

*Kuvatbek Bapaev, AADP, Institutional Strengthening*

The AADP project is the Bank's third project in agriculture and rural finance and builds upon support under the Agriculture Sector Program loan that has been assisting the Government with its policy and institutional reform program for the sector. The project is adopting a new area-focused approach to investment in the agriculture sector in the Kyrgyz Republic as nearly all major development projects in the Kyrgyz Republic are currently being implemented nationwide. Chui *Oblast* has been selected for its potential for agriculture growth and development and its importance to the economy. The project addresses constraints in farm restructuring, drainage and irrigation, input supply, machinery hire services, marketing, and finance. The project aims to integrate ongoing and planned activities to maximize its impact.

### **Rationale**

The crop, livestock, and agro-industrial subsectors are continuing to experience substantial adjustments, partly in response to the ongoing reforms in the agriculture sector. The sector reforms are continuing and progress in their effective implementation has been variable across the regions. The result is that agriculture, despite the upturn in recent years, is underperforming as many of the farms and agro-processing facilities are not operating efficiently and are not financially viable. A concentrated and coordinated focus on key constraints at the farm level to

bring together and enhance the impact of ongoing and planned investment projects will be adopted. A regional/area focused approach will ensure the effective coordination of the Project with other activities. The challenge of the project is to integrate the various supporting initiatives into a coordinated agriculture development program aimed at supporting the key investment needs and related linkages between public sector investment and private sector initiatives.

## **Objectives and Scope**

The long-term development goal of the project is to increase the incomes of farmers in Chui *Oblast*. The immediate project objective is to increase farm productivity and profitability in selected areas. Within the Chui *Oblast*, the project focuses on selected geographical areas that coincide with the boundaries of the former state and collective farms. While selection criteria are identified, participation will depend on the demand, capability, and willingness of individual enterprises. There are four components: (i) farm development, (ii) drainage and irrigation, (iii) development of private sector market and input supply services, and (iv) project management. The project provides on-the-job training and other training to increase the understanding and level of skills of farmers and entrepreneurs.

The project will increase productivity and profitability on about 55,000 ha of irrigated farm land. The benefits will include better input supply, machinery leasing services, improved water management, and improved farm management and business enterprise development. The beneficiaries will be farmers located on 20-30 farmer collective and state farms. Farm incomes are expected to increase threefold.

### **Key points:**

The project total budget is \$36 million with \$11.4 million for civil irrigation works, \$10 million for the Kyrgyz Agricultural Finance Corporation (KFC), and the balance for consulting services, operational costs, and vehicles and equipment.

The farm development component includes restructuring and registration of farms as legal enterprises, assistance in management and business planning, facilitating access to credit, training of trainers in cooperation with the World Bank sponsored Rural Advisory Services (RAS) and local training institutes.

Key elements of the drainage and irrigation component include on- and off-farm irrigation and drainage rehabilitation, and land management and soil protection training. WUAs will repay 25 percent of on-farm rehabilitation costs.

Subsidiary field trials include sprinkler and drip irrigation techniques, land leveling, shallow drainage, tube wells, on-farm water management techniques, and water management software.

Private sector input supply and marketing involves marketing and enterprise development activities. Activities for both domestic and export markets include development of marketing groups and contracting with processors and wholesalers, and participation in overseas trade fairs and identification of market buyers. Enterprise development activities include machinery

contract services, repair services, development of spare parts dealers, and support for small machinery (mini-processor) manufactures.

Project implementers have include legal advisory services in the farm development component. Services are provided in collaboration with the Helvetas LARC project, ARD Commercial Law project, and the Chemonics Land Reform Project.

World Bank RAS offices and ADB collaborate on training programs

## **B2d. European Union projects**

The EC-TACIS supports the following programs in the Kyrgyz republic:

- SME development project – a wide ranging program that focuses on enhancing access to business, finance, and export markets. Activities are implemented by local NGOs and consulting companies.
- Policy advice to the state securities commission.
- Support to the Training Fund

Kyrgyz Agriculture Market Information System (KAMIS) was established by British Know How Fund at the end of 1996 as an experimental project in two regions with headquarters in Bishkek. The KAMIS activity was, we believe, later supported by the World Bank ASSP project.

The purposes of this project were:

- Foundation of the most suitable mechanism of the collection and distribution of the market information for providing a transparency of the market
- Provision of producers of agricultural produce with database about agricultural material and technical resources.

KAMIS weekly prepares:

- Weekly bulletins on the prices, with the information on:
  - Market prices in the main markets of cities of the Republic
  - Average prices in the markets of neighboring states
  - Average prices in regional markets of the Republic
  - Average prices in large cities of Uzbekistan, Kazakhstan and Russia
  - Daily dynamics of exchange rate of basic currencies on Kyrgyz Republic.
- Weekly newsletter *Spring field Works* , which includes an extensive database on demand, supply and services (DSS).

The above described information is delivered to all participants of agricultural sector at all levels, starting with the Presidential offices, Heads of Agricultural Administration at a rayon level, the Ministry of Economy, Ministry of Agriculture and Water Resources, and other direct or indirect participants of agricultural sector. KAMIS publishes the *Monthly Price Bulletin* containing prices for agricultural produce, analytical materials on agricultural market, and information on a condition of agricultural sector of international markets. KAMIS also cooperates with a number of state and non-state organizations in Kyrgyzstan and abroad.

### **EBRD: Small and Medium Business Project**

As in other Central Asia countries, the European Bank for Reconstruction and Development

EBRD has established a program in the Kyrgyz Republic to provide selected commercial banks meeting the EBRD financial, operational, and managerial criteria with access to an on-lending line of credit for SMEs as well as technical assistance to develop the policies and procedures for SME lending and to train loan officers to implement the program. Four banks have been selected for the EBRD program—Demir Bank, KazkommertsKyrgyzstan Bank, Kyrgyz Inegximbank, and Akab Bank. More will be added as interest develops and commercial banks improve. Meetings with program officers in Bishkek and Osh provided the following points of discussion about Kyrgyz banking and the SME lending market.

- The Kyrgyz banking community has too many banks (20) chasing too few bankable businesses and has too few resources to develop sustainable commercial banking businesses.
- The EBRD program has 700 loans for a total of \$1.5 million with an average loan size of \$2,000.
- The program loans range from \$1,000 to \$50,000 and applications greatly exceed loans disbursed.
- The EBRD has a huge backlog of loan applicants of good businesses because of the limited availability of good lenders to serve them. Commercial banks simply have not bothered to understand how to lend to the very large and growing SME market. The EBRD program is starting slowly but will accelerate nicely with growth curves similar to the Kazakhstan program.
- Kyrgyz commercial banks want to become real commercial banks but have limited loan officer training and inexperienced management in commercial banking.
  - Rely on a small number of corporate loans
  - Competition for those few clients presses operating margins until most of those loans may not be profitable
  - Many banks trying to learn the SME market by trial and error

- Loan officers do not have the technical capability to develop SME loan portfolios—application processing, credit analysis, loan terms and conditions, loan pricing, loan administration and monitoring, and loan collection, workout and foreclosure.
  - Many banks have inquired about joining the EBRD SME program but do not meet the EBRD’s stringent financial condition criteria for participating in the program
  - Charging 50 to 70 percent interest on many loans—most go bad.
  - Make up losses from the failed loans from the few that are able to pay the high interest rates
- Many bank loan officers are additionally ill prepared to lend to the agricultural sector as they do not understand the underlying economics of each type of agro-industrial, processing or production business, their cash flow needs, their revenue streams and their business risks.
- Agroindustrial and food processing industry is in poor shape with few bankable projects.
  - Most owners have unrealistic business visions of gaining huge returns quickly and then selling the business.
  - Most have a Soviet era attitude of demanding money without giving information, collateral, or a business plan for the money’s use. Many managers simply say, “Trust me.”
  - Few have any understanding of the market or how to access it. Many simply want to recreate the Soviet era markets.
  - Most of the firms trying to operate with Soviet era equipment and poor packaging, canning, and labeling
- Current pledge law makes it difficult for creditors to realize collateral in the event of a debt default. New law also has many flaws and will simply limit lending
  - Mandatory registration of collateral requiring notarization—very expensive, particularly for small loans
  - Office of registration does not have a fully organized electronic system for learning whether collateral is previously pledged
  - Lenders must pay government officials extra to have any reasonable search.

- New law will add \$10 to \$30 per loan in fees, making many types of microlending and SME lending too expensive.
- The new law approach will simply force many borrowers back into informal high interest lending.
- Registration of land mortgages is required under the law and notarization is not. However, the land registry offices will not accept a mortgage for registration unless it is notarized.
- Bottom line for realization of collateral and land under mortgage—eventually a creditor will get something from foreclosing on the collateral or land, though not 100%, and it takes a very long time and is very expensive.
- Current and proposed pledge laws simply increase the cost of lending and the government rent-seeking points of contact.

## **B2c. Other donor projects**

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### **HELVETAS / Swiss Association for International Cooperation**

*Policy Support Project, Ministry of Agriculture*

*Ainura Kupueva, Director of Agriculture Projects Coordination*

#### **Key points:**

- The focus of this project, started in 2001, is institutional capacity development of the Policy Analysis Unit in the Ministry of Agriculture.
- Monthly group meetings share information on the different donor projects. This includes village level councils (*Aiyl Okmote*) and district level agricultural departments.
- The unit collaborates with GTZ on the development of cooperative models to be piloted in three regions. A review of the cooperative law that was approved by parliament in 1998 is being conducted by the USAID-sponsored commercial law project.
- The unit conducted a participatory rural survey of 250 respondents in three districts of three regions. The purpose of the survey was to get an overview of the status of agrarian and land reform. This survey led to a 180-person roundtable meeting on reform issues.
- The Ministry also continues to support the market information project (KAMIS).

- The Policy Analysis Unit advocates reform through a Ministry working group that links with parliament. This group has also focused recently on stakeholder involvement.
  - Policy issues include: 1) legal basis for land market, 2) extension services and research, 3) marketing through an export promotion agency, 4) water improvement strategy, 5) leasing and insurance issues, 6) production and processing taxes (VAT), and 7) WTO legal issues.
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## Kalys Consult - Land and Agrarian Reform (NGO)

### Third Party Arbitration Courts

*Tashbolotov Maksatbek, Director*

KALYS consult is a public foundation established in 2001 that specializes in land and agrarian relations, information services, consulting, surveying, and conference training. KALYS has introduced third party arbitration for resolution of land and property disputes to improve the livelihoods of the rural poor.

### Key points:

- Implementation of the UK/DFID, 2001 to 2004 land and agrarian reform project with SAC international. This program lobbied for legal reforms and provided advisory and dispute resolution services through eight regional offices.
- Training in land rights with the World Bank Center for Land and Agrarian Reform under the ASSP. Provided land rights trainings services on demand for the center.
- Legal advice on rural property cases, with the UK/DFID Land Reform Project
- Provided training in arbitration law and practices for the Center for Judicial training.
- Implementation of the Arbitration in the Agrarian Sphere Project (AASP) as an effective, accessible and low-cost procedure to protect the rights of rural residents and agricultural organizations during the transition to a market economy and private ownership of land.
- There is a growing need for water pricing arbitration. Water user rights and the application of the evolving regulations for water are not understood by rural farmers. KALYS has collaborated with ADB project in Chui region on these water issues.
- 33 percent of KALYS cases deal with land share issues; 18 percent with property issues; 10 percent with land boundary issues; 8 percent with water issues; and 8 percent with rental issues.
- Also, 39 percent of the disputes are between individuals and state entities; 33 percent between individuals and legal entities; and 22 percent between individuals.



## Department of Water Resources

*Beishekeev Kydyrbek Kanimetovich, 1st Deputy General*

*Alex Sizintsev, Chief Water Consultant to the Ministry*

- Organization of the Ministry – separate arrangement for Water Economy Department.
- Responsibilities of the department as for normative water supply and for water use policy, includes section of WUA support – which has the support for WB project
- Dept of rural water supply
- Land ownership of farmers – possibility under new land law, state reserve 30 percent
- Oct 1, 2002, 256 WUAs; WUAs law passes in 2002
- New tariff for water – big discussion – (0.03 som/m<sup>3</sup>, realistic price would be 5 times more
- 2003 – proposal for higher tariff to the parliament
- Water code draft – five revisions – this year to parliament for decision
- In every *oblast* there is now section for WUA support.
- Average size 1,500-2000 ha, mixed membership -land ownership; may have several hydro units.
- More legal support will be needed in accordance with the newly proposed organization of water to basins. – USAID good support previously.
- The change to basin management will also need to be reinforced by training, workshops
- Under the basin water management the functions of administrative management, plans, policy, licensing will be the role of state, then basin management, and O&M at the lowest level by WUAs.
- WUAs still need a lot training support, materials to read.

## Irrigation Institute

*Nurlan Djailobaev, Chief of the On-farm World Bank Project*

### Key points:

- Program of the WB project – need much more training than under the project
- Need start up funds for WUAs – not enough funds under the project for a proper training and equipment (projector, camera, flip chart stands, etc.) although the training center in Bishkek was equipped is being established
- WUAs need training in administration, financial mgmt, water distribution, answers to organizational questions to water supply, budget making, engineering improvements
- Conflicts in water measuring – within WUAs between farmers and between WUAs and *raivodkhoz* – not enough accurate devices
- Taxes for farmers, WUAs are being reviewed now
- Also water price change is under consideration – up to 0.06 som/m<sup>3</sup>
- New water law for consideration
- Coordination of the IWMI/SIC for WUA charter and the approach is not good, farmers are confused; Fergana model not useful
- Farmers and others need a mind change set – water service is not going to be free of charge
- Cooperation with ADB is good
- Points with Kichibaev, chief of the PIU WB:
  - Three projects, one PIU: rehabilitation, flood protection, on-farm
  - Also in 26 *raions* @ 3 people for WUA support
  - Need help to better identify where network need repair
  - There are 34 training centers, *raions*, *oblasts* – mainly computers
  - Better complex training for all – water and agricultural needs because we need to make sustainable WUAs who can help to repay the loans; the present rate of cost recovery on water is very low.

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## Ministry of Agriculture, Water Resources and Processing Industry of the Kyrgyz Republic

*Aleksandr Vasilievich Kostyuk, Minister of Agriculture*

*Saparbek Mambetovich Tynaev, Head of Agriculture Policy, Foreign Economy and Investments*

The consultants met with the Minister of Agriculture in order to get a sense of the priority issues for agrarian reform from his perspective.

### Key points:

- The Minister noted that Kyrgyzstan is different from the other Central Asian countries with its own specific set of problems.
- Kyrgyzstan is the most progressive in land reform, in terms of more actively developing land markets. More needs to be done, especially incorporating more legal advisors in this work. The aim is to remove all restrictions on land shares.
- The Ministry would also like to develop a new class of private farmers and help them become more efficient in production.
- The development of agricultural services is part of the reform policy. Machinery, inputs, veterinary, and other consulting services, need to be further developed.
- It is vital that the procurement and sales process be solved; the World Bank will help us with an agribusiness and marketing activity.
- The Ministry is also very interested in attracting foreign direct investment and the conditions to this today are most favorable. There are currently eight foreign investment projects. In this area the Ministry works closely with the Secretariat.
- The Ministry would also like to develop an export promotion capacity within the Ministry. We would require a partner to help us accomplish this objective. The Kyrgyz embassies could help us to promote Kyrgyz products.
- Regarding cross-border trade, there are ongoing discussions at all levels to solve some of these transportation constraints. There are many barriers to trade for Kyrgyz products that will be issues under WTO that need to be resolved. There is a need for a universal CAR decision on these cross-border transportation issues.
- The Ministry is trying to improve the seed certification process to facilitate imports of improved varieties. They have decreased by fivefold the number of licenses required for seed imports; also trying to do “one-stop shopping” for permits. The State Commission on Standardization and Metrology recognizes certificates under WTO.

- Regarding WUAs, the first area of priority is management. These are not commercial organizations and do not suggest burdening them with new responsibilities.
- Last, there is a need to coordinate all activities with the Ministry if desire to really create synergies. The Ministry is very open to coordination and collaboration.
- The Ministry could always use more training assistance and information processing resources—many needs at the local level in the effort to become more efficient.

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**HELVETAS / Swiss Association for International Cooperation**  
**Support to Private Initiatives Project**  
*Eugene Ryazanov, Project Leader*

This is a small project with three staff members that focuses on business advisory services and agro-processing.

**Key points:**

- The project works through local service providers on management, trade, transportation, and communications. They work with agricultural processing enterprises.
- A survey they conducted identified 350 agro-processing enterprises in Kyrgyzstan; 38 are private fruit and vegetable processors mostly located in Osh, Chui, and Batken regions. They identified about 35 enterprises in dairy processing, 20 in tobacco, 25 in cotton, and four or five in fish production.
- The Kyrgyz processors prefer to pay for services from private service providers. Most of these providers are in Bishkek. The project works with about 70 companies and has published a directory of service providers that includes contact information on providers and the type of service they perform. Because very few service providers that have specific agricultural production or processing knowledge, there is a need to develop this capacity
- There is also a need to develop a fruit and vegetable industry strategy with clearly defined objectives and roles.
- The three major constraints are marketing, appropriate technology, and working capital.
- There is no basic information on credit resources available for agricultural processors.
- Customs regulations are an issue. The project produced an export/import booklet with customs procedures and examples for exporters. The project also sponsored a workshop with Russian companies on trade of food items, completed a Russian marketing survey,

and published a brochure on tax information and other issues of doing business in Kyrgyzstan.

### **Recommendations:**

- AID should support a publishing house for all donor projects to publish and disseminate technical information.
- Need to work with trade companies on fresh fruit and vegetables marketing. The problem is that most traders are small with very limited working capital and Russian import demands are huge. Commercial banks will finance trade at 42 percent interest.
- There is a need for a Trade Guarantee Fund – to provide affordable trade finance.
- AID should not support small processors, because their small lots will be hard to market and limited to local markets that seem to be full. It is better to support linkages between producers and processors through an intermediary such as an association or private businesses.

### **Secretariat of the Special Representative of the President of the Kyrgyz Republic on Foreign Investments**

*Jamar Otybaev, Deputy Prime Minister*

*Rafkat Hasanov, Deputy Special Representative and Advisor to the Deputy Prime Minister*

The President established the Investors' Secretariat for local national and international business leaders to share information and discuss the excessive legal, regulatory, and administrative barriers to business development in the Kyrgyz Republic. The President is committed to an annual retreat with the Investors' Secretariat to hear the most serious impediment to business. Most important issues currently before the Secretariat include:

- Osh Initiative: Government wants to make progress in improving the agro-industrial and food processing sector and wants to make progress in Osh.
  - To date there has been a misunderstanding in Osh of USAID's commitment.
  - Locals are expecting the availability of credit.
  - Kyrgyz government is committed on its part to reform in the regulatory process and has two staff professionals in Osh engaged in regulatory reform.
  - Kyrgyz economic future relies on first establishing a strong agroindustrial and food processing sector.
  - Government streamlining needed.

- Water User Associations
    - Need organizational and operational development of WUAs.
    - Improved water resource management must extend to business use.
    - Severe problems with water distribution in some areas.
    - Need many improvements in the potable water supply.
    - Water disputes are extensive, particularly with Uzbekistan.
    - The Kyrgyz government wants to engage in discussions with neighboring countries and resolve issues.
  - Would welcome greater USAID involving in the Secretariat in conjunction with the Osh Initiative.
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## GTZ - Training and Extension System (TES) project

*Torsten Swoboda, Project Manager*

The TES project began in 1996 as an advisory organization with a long-term commitment to farmer capacity-building.

### **Key points:**

- The Training and Extension System is a management unit to train 20 to 30 independent field advisors (currently 25 active) in agriculture extension techniques. These advisors charge a fee for services. Membership in TES is about \$20 per year.
- Three sources for advisors: 1) learn at center and apply on their own production fields, 2) advisory contracts with other non-TES farmers who seek crisis management advice, and 3) TES contracts with other donor projects to collaborate on multi-function interventions.
- Processors have turned away from producers because they want to control the land by themselves and don't seem to want to establish long-term relationship with producers.
- Need to focus on linking producers and processors; there is no trust between these parties at the moment. This requires intensive and focused work.
- Field advisory work may not be enough for some producers, so have an option to attend farmer training school. TES contracts with specialists and makes an order for a training activity on a specific topic, e.g., cotton cultivation. If there is a group of farmers they will also do a demonstration.

- The World Bank RAS project employed field advisors (extension agents) but their travel costs were too high and farmers could not pay for services.
- Most of the large farmers (cotton) don't require much in the way of advisory services. It is the small-holders that need considerable assistance.
- There is a cotton association with ginnery contracts that has a seed oil mill. This association has planted 500 hectares of new varieties and will trade product by themselves. There is no grading facility and thus quality premiums are not paid. This association has been a success because of the leadership of one individual. Associations need good leadership and this will require training in management and technical issues.
- The TES advisory network could collect farm level data; they already have good farm budget information.
- Osh has several agro-climatic zones and thus there is a need to consider each zone independently. Also, there is no typical farming system in the Osh valley. There are a multitude of complex systems. Farmers tend to market from field, at lower prices, in order to get quick cash. It is not easy to sell through an association because of bad experiences with cheating and late payments.
- Needs include: small units of inputs and packaging for farmers and local reliable trading partners for assembly and marketing.

### **Recommendations:**

Finance for production and processing is a key constraint. AID should consider a small revolving fund that facilitates producer/processor contracts; this could be developed through a long-term partnership that focuses on trusting relationships. There is a need to train lenders – traders – producers in agriculture finance. There is a common understanding of the risks involved in lending to agriculture enterprises.

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### **GTZ – Support to Self-help Initiatives in Rural Areas**

*Christoph Weber, Project Manager*

### **Key points:**

- Over the last ten years, agro-industries in CAR have not proven themselves to be good business partners with Russian companies. Regaining markets and building trust will be a major challenge in light of emerging competition from many other countries.
- Small trade seems to work and is the main business, whereas large investment initiatives have not generally worked.

- Problems begin on-farm with poor management and little technical knowledge. There is no way processors can trust producers and thus have problems to sell their products.
- One mistake of donors is to focus on a few enterprises. In order to be sustainable, they should work with small groups over longer periods of time.
- The credit problem is grossly overstated. You can find money from family investors. The main problem with commercial lending is the lack of enforcement and high risk, which contributes to the lack of trust problem. The credit system is wrong and can not be fixed from the outside. Need to reform the system to be sustainable.
- Small group projects should well planned in advance and include seasonal effects and commitment to long-term activity.
- If desire effective coordination, then need a strong coordinator or the strategy will not work.
- Small to medium scale fruit and vegetable processing makes sense. The ginneries seem to work well and there is a fair amount of competition.
- The Almaty market is attractive, but F&V producers and processors will have to compete with Shimkent, the Uzbek producers and processors, and the border transport issues.

## RAS – Rural Advisory Services, Osh office

*Petra Geraedts, International Advisor to RAS Osh Oblast*

The Swiss have made considerable investment in the agricultural sector in Kyrgyzstan during the past few years, mainly within the framework of the Kyrgyz Swiss Agricultural Project (KSAP). These activities have allowed them to gain extremely valuable experience that will be used to good effect in phase IV of this program.

The overall goal of the program is “to contribute to poverty alleviation and to improve the living conditions in rural areas of Kyrgyzstan through agricultural advisory services.” The program’s goal was defined as follows: “With the support of the KSAP, effective, decentralized, demand driven extension services, steered by farmers' councils, are in place.”

KSAP supports the countrywide Rural Advisory Services (RAS). In phase IV, the KSAP will extend the progress achieved during phase III, namely, supporting the Rural Advisory Services in Kyrgyzstan through technical assistance and joint finance. The main efforts will focus on a more decentralized approach—farmer-owned rural advisory services controlled by farmers' councils—as a new structure. The KSAP ensures: 1) technical assistance of Expatriate Advisors to RAS in all seven *oblasts*, Coordination Unit, and the Advisory Training Centre in Bishkek Methodological support, including extension training courses for RAS staff and study tours



**Key points:**

- The RAS centers are registered NGOs with a three-tiered structure in seven regions, i.e. offices have representatives at the regional (*oblast*), district (*raion*), and village levels. There is an expatriate technical advisor in each regional office. RAS is the most extensive agricultural network in Kyrgyzstan.
- Each village has a farmer council with an elected chairman and a representative at the district level. Eventually, RAS is planning to federate this entire structure across nine regions. The federation (Union) will have a chairman and will meet annually. Regional manager meetings are held every three months. The Kyrgyz are responsible for all administrative and implementation activity.
- In the Osh region, RAS worked in six districts in 2002 and one more in 2003.
- The regional manager is assisted by three technical advisors (agronomy, livestock, and gender specialists) and there are also three specialists in these areas at the district level.
- For example, in one district, RAS will work with 40 village promoters. They are paid 500 *som* per month (\$12) and receive training by RAS staff. Farmers say they will pay for advisory services if helps increase their production efficiency.
- Primary issues for farmers: marketing and market information, input supply, and finance.
- RAS assists with farm planning and focus on cash crops such as seed potatoes. Extension service topics delivered in training centers include early vegetable production, storage, and marketing.
- Collaboration with IFDC is on going; demonstration plots and seed variety trials.
- There is a need for appropriate technology—small hand processing machinery—maybe from China.
- Livestock is traditional activity, but need artificial insemination, feed, and winter hay. Many women's groups want to buy cows. Milk production is good cash income for family. Women groups are also interested in fruit drying however there is an investment issue; no investment or working capital available for these activities.
- There is a need for association development—getting individuals to work together. The RAS women groups seem to be viable. The RAS advisors form groups of ten women and then support these groups with training activities.
- The major problem between producers and processors is a lack of trust.
- There are a few fruit tree nurseries started in different villages and this seems to be a good business.

## Recommendations:

- Regarding processing: need to consider micro-enterprise development activities. Investment funds for medium to large size enterprises are not available. There is a need for small scale step-by-step processor development approach. Processing of cotton seed for oil, what thrashing and milling, fruit and vegetable drying. Baking of bread is done at home. No sausage and meat processing is done at the market or side of the road. The silk industry is dead. There is potential in small milk processing.
  - Sun drying: need to move from traditional to commercial activity by working through associations. The farmer groups can work but need training.
  - Farmers will say they know everything, but they don't. There is a huge need for training in basic agronomic practices. Helvitas is trying to develop basic education materials for training purposes.
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## German Agro Action (NGO)

*Alexander Poltavtsev, Acting Project Manager*

The project objective is to support small-scale potato producing groups of farmers in the mountainous districts of South Kyrgyzstan in order to increase quantitatively and qualitatively potato seed production and marketing. This will be achieved through a regular supply of high yield potato seed material and other means of production (fertilizer, insecticides, etc.).

## Key points:

- This project began in 1997 with imports of 28 tons of high yield elite seed potatoes that were given on credit to farmers who repaid loan with potatoes from their production. This seed was then provided to other farmers in order to expand the seed production network.
- One problem with this initial activity was that many farmers sold their potatoes for eating at a lower price than they could have received if they sold them as seed potatoes.
- The new strategy is for farmers to purchase super-elite seed potatoes, poor farmers can not pay the \$1.12 per kilogram, so GAA helps with credit as well. The second requirement is for farmers to form groups to ensure production.
- Local consultants provide training in accounting, management, and technical issues.
- In 2002, GAA developed Agro Foundation for Development a local NGO to replace GAA in the future. They are now official partners of the project and with an open social ownership focus.

- There are no potato processors in South, but there is a potato chip maker in Bishkek and GAA has imported potato seed varieties for chips. GAA is also working with a large Bishkek hotel to supply them with potatoes from Chui region demonstration plots.
- One hectare will require 2,700 kgs to plant and the harvest will be 30 to 40 tons. Farmers with old seed only produce 14 tons. The farmers' group (4 to 10 farmers) buys 110 kgs from GAA and the rest is from multiplication stock. A good farmer can make a \$1,000 per hectare. There is no irrigation and they average between 0.20 to 20.0 hectares.
- The seed potatoes are also sold in Uzbekistan and Tajikistan through traders. Some traders visit the farms during the growing period and negotiate a sales contract with the farmers at that time. Some traders even make a partial payment in advance.
- The project helps farmer groups with inputs during the first year and then they handle the purchase of inputs on their own after the first year.
- The project has hosted Farmer Today designed around a field day activity. They drew 62 groups (over 261 farmer members, but 1,000 farm workers) to the activity. In terms of job creation, potatoes require three to four workers for planting and harvesting so create lots of jobs.
- The potato model could also be used for tomatoes.
- If the Kyrgyz farmers could get their seed certified they would be able to get even a much higher price for their seed potatoes. This is one of the objectives of the need association.
- It would be interesting to form a regional (Fergana Valley) cooperative unit to produce, and market certified potato seed in CAR.

### **Recommendations:**

- Look at potato storage issues and appropriate technology
- Collaborate with LARC project on legal issues.
- Cooperate with GTZ on agronomic training activities.
- The agricultural faculty in Bishkek should also be included in development activities. GAA invites their specialists to participate in training activities.

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## Private Trade Company, Prim-Osh

*Clara Primova, Director*

Clara explained that she began her company in 1998 as an exporter of cotton. She realized that producers needed help with marketing and input supply and she began to import fertilizer as payment for the cotton exports. This is often how trade is financed in Kyrgyzstan.

### Key points:

- She has a contract with a Turkish company to export 500 tons of dried fruit, mostly apples. She has already assembled and exported 150 tons by truck.
- She won a tender to collaborate with the International Fertilizer Development Center (IFDC) supported agribusiness association on the import of 60 tons of complete fertilizer.
- She has opened a new and unique store in the South that sells improved seeds, fertilizer, crop protection chemicals at reasonable prices. She also distributes these products in three regions with a team of twelve distributors. The distributors develop orders and deliver products on a cash basis. Farmers would like to have credit, and they have provided inputs on a 50 percent payment basis with terms.
- Would like to work with IFDC and arrange an input supply import guarantee facility. This would help with the finance of larger lots and help lower costs for the farmers
- She has worked with Pragma on the export of fruits to Russia where she has partner buyers for fresh produce. She hopes to develop the market for dried fruits in Russia as well. The profit potential for dried fruit is very attractive and this is a technical area that would be good for foreign investors. The preferred products are apples, plums, and apricots. She has over 100 workers in season to help with the drying of apples for her Turkish contract.
- She believes there is interest among producers to form a western style cooperative for importing inputs and exporting added value products. She notes that it is difficult to unite farmers.
- There are about 15 to 20 traders in the South doing similar type of businesses. She has been involved with trade for 13 years and can manage large volumes. Most others can not.

### Recommendations:

- Farmers don't have access to information, and help in this area is important.
- Finance is key; cannot grow without affordable finance.

- She would like to develop a fertilizer credit activity through an association.

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### International Water Management Institute, Osh office

*Alisher Satybaldyev, Project Manager, IWRM – Fergana project*

#### Key points:

- Institutional changes contained in the water law—hydrographic management principle.
  - Law on licensing is higher than law on WUA—will need amendment; discussion on WUAs licensing; some USAID projects recommended no licensing for WUAs.
  - Mechanisms for coordination for greater water abstraction—permits issued by State Mineral Agency
  - After the water law will pass, many reforms will need to be conducted.
  - Under WB project WUA charter was prepared—contradiction with Fergana project
  - Problems with tax code of Kyrgyzstan—do not foresee exemption for WUAs, (WUAs do not have to pay VAT).
  - Local water departments have support units for the WB project.
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### Kyrgyz Agricultural Finance Corporation

*Baktygul Jeenbaeva, Executive Director*

The Kyrgyz Agricultural Finance Corporation (KFC) was established in 1996 by the Kyrgyz government and the World Bank as a collaborative effort to provide a financial institution committed to serving the agricultural and rural sectors after the demise and liquidation of the Soviet era Agroprombank. The KFC is a nonbank financial institution that operates pursuant to a NBKR exception to the Kyrgyz banking laws and is managed by Kyrgyz government employees under the direction of a six member board chaired by the Minister of Finance. The government provided the KFC's initial capitalization and the World Bank provided on-lending funds through an IDA loan facility. The ADB has joined in providing additional funding through its own soft loan facility. Major points of operational and financial information about KFC include:

- Cost of Funds: The KFC borrows WB/ADB funds through the government from the Ministry of Finance at the WB/ADB rate plus the Kyrgyz inflation rate plus a margin for the Ministry of Finance administrative cost. Administrative fees include the 1 percent WB/ADB commission spread over the life of the loan and foreign exchange risk.

- $(.75\%)(WB/ADB) + (5\% \text{ to } 6\%) + 2\%$  (Min Fin admin) for a funding rate of 7.75% to 8.75%
- Cost of funds is adjusted every six months to reflect current inflation
- KFC operates largely as a rural microfinance bank with both group lending and individual collateralized loans similar to other microfinance programs. Approximately 20% of its portfolio is group lending. Loans range in size from \$300 to \$1500 for group loans of less than one year and up to \$250,000 loans with a maturity of up to 7 years.
- Loan Rates: KFC lending rates reflect its cost of funds and its perceived operational and credit risk of its portfolio:
  - Rate for best borrowers of several years experience: 15% per annum
  - Average loan rates are 18 to 19%
  - Most risky clients are charged 25% to 28%

**Table 3: KFC Capital, Assets, and Performance Ratios for the past 3 years, Kyrgyz Som**

	2000	2001	2002
Average Assets	572,983,400	727,816,900	1,039,783,500
Average Capital	213,187,000	290,792,800	332,107,400
Net Income	11,934,800	29,498,500	84,437,800
Return on Assets	2%	4%	8%
Return on Equity	6%	10%	25%

- Though KFC took several years to turn a profit, for the past three years, KFC has achieved increasingly positive performance ratios with return on assets and equity.
- During the next five years, KFC wants to take deposits (current account and savings) to have a long term funding source after the WB/ADB debt funding is retired
- KFC is also looking to develop risk management products, including crop insurance, foreign currency accounts, and leasing. The bank believes that commercial crop insurance may be successful in Kyrgyzstan because the government does not have sufficient funds to provide disaster or other emergency assistance that undercuts the ability of insurers to develop a sufficient sized insurance pool.
- KFC operates throughout the country through 11 branches and 45 regional offices and an operational loan staff of 200 officers.
- KFC's biggest current operational weakness is internal communications and the lack of a modern computerized management information system.
- At the outset of KFC's development, it was intended to be privatized after it became fundamental sound and financially sustainable.

- KFC currently needs more liquidity but is waiting a new tranche from the WB/ADB based on certain conditionalities including a comprehensive three-year business plan.
- KFC will be seeking a general banking license to put it on par with commercial banks and a phase-in period for it to take deposits.

### **B3. Recommendations to the Mission**

The scope of work states that the contractors are to present opportunities (if any) for increasing assistance to the sector that may add value to the activities already being implemented by the offices of EW and EF. This section provides the consultants' recommendations for creating synergies among activities already being implemented as well as recommendations for new activities.

#### **B3a. General integrated agriculture and water resource development model**

This section of the report describes a generalized integrated model that could be implemented in different locations within the four CAR countries. Country-specific recommendations are made under section B3b. The consultants advise USAID designers to consider all elements of the generalized model as they assess the potential of the approach in specific locations.

The consultants recommend that USAID consider designing an integrated agriculture and water resource development activity adapted to local conditions within Kyrgyzstan. We use the term integrated from two perspectives: 1) the integration of value-chain participants (production, processing, marketing, allied industries, and market intermediaries) into a systems approach; and 2) the integration of mutually beneficial donor funded activities into a targeted geographic area to capture potential synergies among existing donor projects.

Within a geographic area the integrated approach would focus existing resources in pilot hydrographic units based on proximity to existing donor resources. This activity would also focus on agro-industries in the water unit such as a fruit and vegetable or cotton industry. Why target enterprises within a hydrographic unit? There are a number of reasons, notably, enterprises in a hydrographic unit: 1) share similar agro-climatic conditions, 2) are part of a common and structured community, 3) share similar constraints and opportunities for growth, 4) have a common enabling/regulatory environment, 5) can provide a more effective water management approach, and 6) enhance the ability to foster necessary cooperation and trust.

The rationale for an integrated approach is based on the need to: 1) facilitate transition from Soviet planned agriculture to market-oriented system, 2) focus on land issues because many agricultural development issues revolve around land rights, ownership, use, including the ability to buy sell and mortgage land, 3) mediate, if not resolve, land tenure and water management issues, 4) recognize sustainable agricultural development including production, processing, finance, and marketing activities, and 5) create synergies among donor projects by focusing diversified resources on common problems.

The primary goal of this approach would be to demonstrate to the GOK how to achieve sustainable growth, through increased efficiency, in agricultural production, processing, and marketing enterprises and the networks in which they operate. Secondary to this goal, the approach will help: 1) reduce poverty, 2) manage natural resources, 3) contribute to national food security objectives, 4) ensure increased revenues for agricultural producers and rural citizens, and 5) build private/public partnerships, sustainable enterprise, and linkages among participating beneficiaries. These goals are consistent with government strategies and thus their willingness to support targeted pilot programs.



## Critical issues

The primary criteria for the selection of a targeted geographic area (hydrographic unit), is the presence of significant donor activity. Implement where resources are available and strive to create synergies among existing projects.

*Caution.* The consultants are not suggesting that USAID and other donor projects integrate their entire work plans to focus on this single geographic or hydrographic unit. We recognize that that would be impractical, if not impossible. What we are suggesting, however, is that the individual projects can dedicate a small portion of their expertise and resources to collaborate in the development of the integrated approach in the target area. For example, the LARC project has 18 offices in Kyrgyzstan, so let us suggest that they locate one office in the target area. Likewise, GTZ conducts agronomic training for farmers throughout Osh and other regions. They will be requested to implement a number of their well developed training modules in the target area. Also, IFDC can implement one demonstration field; MASHAV can implement one drip irrigation activity, etc. The consultants believe that limited, agreed upon, and targeted collaboration is possible within a defined geographic area and will produce the synergies expected to the mutual benefit of all participants.

*Coordination and management.* To be effective, USAID should designate a senior coordinator—a “czar”—to manage the recommended integrated activity. The “czar” should: 1) have extensive business development experience, 2) be able to work independently from any one project, 3) be mandated to liaise with projects, donors and officials, 4) be responsible for developing donor project “integration strategy,” 5) have the authority to negotiate individual MOUs with all pertinent projects, 6) be responsible for monitoring and evaluating impact, 7) facilitate inter-country linkages, 8) be tasked with the collection donor project data on needed policy reform that can be used to foster agro-industrial growth, and 9) be responsible for the dissemination policy reform data and memoranda to interested trade associations and business groups who are able to advocate for policy reform.

## Approach:

The Integrated Agriculture and Water Resource Development Activity could be organized into the following four components that correspond with the components of existing donor projects, such as the Pragma EDP project:

- A: Agro-industry Strategy Development and Policy Reform
- B: Association and/or member organization development
- C: Business Advisory Services
- D: Business and Market Linkages

## **Component A: Agro-industry Strategy Development and Policy Reform**

This component would respond to two important needs: 1) agro-industries lack comprehensive strategies for their own development, and 2) agro-industry entrepreneurs can and should lead policy reform efforts.

- **Agro-industry strategy development:** The objective of an agro-industry strategy development would be to bring entrepreneurs together in order to develop agro-industry strategies, where strategies define objectives, constraints, and resource requirements and inform specific action plans. These strategies would be used to orient TA to focus on opportunities and constraint mitigation. Recommended agro-industry strategy development tasks include: 1) The formation of an agro-industry competitiveness council within the targeted geographic area, where the council members would include agro-industry leaders, traders, academic specialists, and public sector representatives. 2) assist the council in the development of an agro-industry strategy, 3) formation of subtopic working groups, 4) assist the working groups in the development of action plans.
- **Policy reform:** The objective of the policy reform activity would be to condition the enabling environment in which these enterprises operate. This would be accomplished by: identifying and prioritizing policy constraints throughout value chain (coordinate information sharing); utilizing agro-industry council's local knowledge and influence to promote policy reform; and by collaborating with associations and NGO's to advocate for reform. Recommended policy reform tasks would include: 1) assist the agro-industry council in policy formation and advocacy, 2) prioritize and target constraints, 3) develop joint policy memoranda, 4) conduct private/public dialogue sessions, 5) facilitate mediation and arbitration activities, 6) land and water user rights, 7) implement awareness campaigns, and 8) collaborate with commercial law and other reform related projects.

### **Component B: Association and/or Member Organization Development**

The objective of an association development component would be to encourage entrepreneurs to form effective member organizations in order to collaborate on 1) joint procurement and marketing mechanisms, 2) organized information diffusion, 3) recurrent training and capacity building, and 4) increase the market orientation of members and democratic processes.

There are different legal forms of member organizations and consideration should be given, depending on resources available in the targeted area. The fundamental question is to focus on a traditional association model or a corporate structure such as the IFC model.

Recommend association tasks include: 1) organization, registration, and governance, and 2) management, agronomic, and business training.

The IFC/Khujand – Farmer ownership model has unique features that include: 1) multi-*raion* representation, 2) mobilized local “champion” entrepreneurs, 3) local and external ownership, 4) strong administration, governance, and accountability, 5) strict business criteria for membership, 6) multi agro-industry involvement (cotton +), 7) significant internal financing mechanisms, and 8) joint input supply and marketing activities.

## **Component C: Business Advisory Services**

The objective of the business advisory services is to increase business capabilities of producers, processors, and market intermediaries. The following needs have been identified for each of these three groups:

- Producers (land users) have limited or no agronomic or animal husbandry education, resource management training, market knowledge, or business skills
- Processors are reliant on old technologies and methods, are not market-oriented, unable to access credit, and they often collude with government
- Market intermediaries provide limited services.

Recommended tasks that focus on producer needs include: 1) technical advice (agronomic, livestock, water management, etc), 2) access to inputs and finance, 3) arbitration and mediation services, 4) appropriate technology advice and access, 5) land and water use rights education, 6) land registration support, 7) land and water dispute resolution, 8) business registration, 9) accounting and bookkeeping training, 10) tax advisory services, 11) water conservation and operations methods, and 12) appropriate irrigation technology. These services could be delivered through associations and/or member organizations.

Recommended tasks that focus on processor needs: 1) business plans (conform to industry strategy), 2) accounting/bookkeeping, 3) quality management, 4) sourcing raw materials and contract production, 5) feasibility analysis, 6) access to finance, 7) advice and access to appropriate technology, 8) corporate registration.

Recommended tasks that focus on market intermediary needs: 1) contracting, 2) transportation cost analysis, 3) cash flow analysis, 4) marketing and promotion.

## **Component D: Business and Market Linkages**

The objective of the business and market linkages component is to facilitate linkages among participants in agro-industry value chain, such as producer-processor linkages, finance linkages, market linkages, and public-private linkages.

Recommended tasks for increasing producer-processor linkages include: 1) production contracting, 2) quality incentives, 3) production financing linked to production contracts, and 4) on-farm quality control training.

The objective of the finance linkages task would be to facilitate financial linkages between borrowers and creditors, in that there is a need to provide a menu of financial options depending on country's formal financial climate.

Recommended tasks for increasing finance linkages include: 1) develop and evaluate credit options, 2) supplier credit, 3) processor forward and delivery contract credit, 4) foreign importer

or cross border credit, 5) bank or micro-finance credit, 5) marketing of project support with creditors to borrowers in order to develop trust, 6) borrower training on financing approaches, 7) loan officer training on agricultural risk analysis, producer/processor cash flows, taxes, and evaluation of borrower character, 8) loan officer training on agricultural loan workout, 9) develop producer/processor credit bureau in associations, 10) develop association based peer pressure on debt repayment, 11) arrange for processor payment to producer through banks, and 12) develop inventory and warehouse receipts credit.

Recommended tasks for increasing market linkages include: 1) export market intelligence, 2) domestic market intelligence, 3) commodity profitability assessments, and 4) knowledge management of data from all projects for policy formation

Recommended tasks for increasing public-private linkages include: 1) need to incorporate local officials and academic professionals in the development process, 2) create mutually beneficial goals and objectives, 3) obtain political will for reform, 4) create sustainability mechanisms, 4) support reform leadership.

### **B3b. Recommendations for creating existing project synergies in Kyrgyzstan**

In this section the consultants present their recommendations to USAID for activities in Kyrgyzstan.

The main theme of these recommendations is to focus and leverage resources—focus existing USAID project resources in selected geographic areas and in a comprehensive manner; and leverage other donor resources to add value to USAID projects.

Recommendations for Kyrgyzstan:

Recommendation 1: Osh - Integrated agriculture and water resource development activity

Recommendation 2: Application of the IFC Farmer Ownership Model

Recommendation 3: Kyrgyz Commercial Bank Training for Agricultural Sector

Recommendation 4: Kyrgyz Agricultural Finance Corporation

Recommendation 5: Introduce USDA type mediation services

Recommendation 6: Kyrgyz Economic Policy—Investors' Secretariat

### **Recommendation 1: Osh - Integrated agriculture and water resource development activity**

Design and implement an integrated agriculture and water resource activity in a target Osh Region hydrographic unit. Selection of the hydrographic unit should be based on existing donor presence, scope of their work activity, and commitment to coordination efforts.

Consideration of ways to utilize existing USAID resources, such as EDP and TIP, to enhance collaboration with other donor projects would be highly recommended.

#### *Critical issues:*

There are a number of interrelated critical issues that need to be considered if USAID undertakes project design work for the Osh Region of Kyrgyzstan that center around the ability of producer-processor-market intermediaries to develop mutually beneficial business relationships. Producers have extremely limited access to seasonal working capital that constrains their production capacity and efficiency. Processors are constrained by a shortage of working capital which further constrains their ability to offer producers/suppliers reliable production contracts. These constraints are further compounded by late payment schemes offered by purchasers of finished products. Markets are underdeveloped and the skills required to develop existing markets are not present to any degree.

There is a terrific opportunity in Osh to create the kind of synergies among donor projects that is required for sustainable agricultural development. Existing donor projects are working on producer, processor, marketing, allied industry, and support institution activities that together, if focused on a target geographic area, could provide the type of development model the government of Kyrgyzstan is looking for in their pursuit of poverty reduction.

#### *Approach:*

See generalized approach above.

#### *Time requirements:*

This activity would run concurrently with the Pragma EDP/TIP funding, which is assumed to be two to four years.

#### *Funding needed to reach program goals:*

Funding would be for a senior business development “czar” and associated working budget. The yearly cost is estimated to be \$350,000 per year.

#### *Key partner organizations:*

Fruit and vegetable processors  
Fruit and vegetable producer and processor associations  
Water district managers – public/private dialogue

Water user associations – water resource management and cost recovery  
IFDC – Input Supply  
GTZ – Agronomic training  
German Agro Action – Seed production and training  
Local NGO to provide – producer training  
Helvetas – Legal advisory centers  
Chemonics – Land and water user rights  
RAS centers – agricultural extension  
Winrock – farmer-to-farmer  
SEAF – investment finance  
Finca – Microcredit  
MASHAV – drip irrigation, fruit drying, and other appropriate technology demonstration sites  
KALYS consulting – land and water mediation and arbitration  
Mercy Corp – CAIP and PIC - community development activities focused on economic development pilots with small-scale fruit and vegetable processors.  
ACDI/VOCA – Bai Tushum microcredit

## **Recommendation 2: Application of the IFC farmer ownership model in the Osh area.**

Implementation of this recommendation would add significant value to the integrated approach in Osh.

### *Critical issues:*

It is the understanding of the consultants that the IDC model could be implemented in Kyrgyzstan as a legal for profit entity.

The issue of commodity focus for the ownership model should be investigated further in order to understand the states willingness to allow private cotton production and marketing, along with fruit and vegetables and other financial attractive commodities.

### *Rationale:*

The consultants were impressed with the manner in which the IFC Farmer Ownership Model in Tajikistan is attempting to resolve an array of constraints on agricultural production, processing, and marketing for its membership. The ability to utilize an organization for the provision of technical assistance to improve production efficiency, resolve linkages with processors, and support marketing initiatives for its members is a fine example of an integrated approach to agricultural development.

### *Approach:*

Implementation of the integrated model described above.

*Time requirements:*

This would require at least a three-year commitment

*Funding needed to reach program goals:*

- SEAF would be one mechanism for the equity investment, if needed
- Three-year technical assistance estimated at \$1 million per year

*Key partner organizations:*

IFC and local producers, processors, and marketers

**Recommendation 3: Kyrgyz commercial bank training for agricultural sector**

Develop program for training commercial bank officers, including: 1) Agricultural production credit and agro-industrial and food processing cash flow and credit analysis training for commercial bank officers of banks interested in learning how to finance the sector or improve their performance; 2) Work with bankers and processors to develop a working capital financing formula that gives processors needed financing and bankers secure comfort of repayment or collection upon default, 3) Work with bankers to develop appropriate loan pricing programs that meet their profit and revenue targets; have comfortable gross and net interest rate margins; and reflect the reasonable cash flows that agricultural sector borrowers can generate.

Bank officer agricultural bank training should be available to all commercial banks and nonbanks, such as KFC financing agriculture.

Develop borrower training to improve the quality of their business presentations to bankers and their understanding of what banks will and will not do in financing a borrower's operations. For example:

- Borrower training of promising agroindustrial businesses (food processors, wholesalers, processing and marketing associations of producers)
- Technical assistance in seeking nonbank credit for agricultural production—supplier credit, processor credit, trade credit
- Promotion of quality agro-industrial, food processor, and agricultural association borrowers to banks for seeking financing
- Meeting with banks to learn of their interest in financing the sector
- Learning of banks' capabilities, rates and fee structures, business plan and information requirement

- Assisting borrowers in preparing business plan financial projections, including loan servicing costs in accordance with average bank rates and fees.

*Rationale:*

Government, donor, and business officials have strongly commented on the limited knowledge of bank management and loan officers on the underlying economics of agro-industrial, food processing, and agricultural production. Because the agricultural sector is a high volume, low margin business with substantial internal and external risks, lending to the agricultural sector requires substantial understanding of the business, the people involved, the product cycles of different commodities, and historical markets and market trends.

A high element of the creditworthiness of any agricultural sector buyer is character—is he or she capable and going to do what is proposed—in addition to having adequate capital and assets, experience in the business, good credit history, and favorable economic conditions to generate proposed revenues from market sales. Bank and borrower need to get to know one another as both face substantial risk if either does not do what is promised

- Banker: If borrower does not grow or processed the purported crop or product, the banker has little to liquidate other than land and machinery at a fire sale price. Rarely do agricultural lenders come out whole in the case of a loan default.
- Farmer or processor: If a banker does not provide the promised funds during the narrow time window in which they are needed, then the entire crop will not be grown or processed as the case may be. Timing is critical.

Agricultural bank training program for loan officers and borrowers can present many opportunities for lender and borrower to learn about the other and develop the type of long term bank/borrower relationship critical to quality commercial agricultural production and processing.

*Budget and Level of Effort:*

Assuming one full time in-country agricultural banking specialist developing relationships and assisting banks and borrowers, combined with a series of agricultural bank training modules tailored to the banks and customers—a budget of approximately \$350,000 to \$500,000 per year.

PRAGMA is the best situated current donor to provide this training and function but should be separated from but remain complementary to the EDP effort due to the obvious conflict between business development and promotion and credit training, assessment, and access facilitation.

#### **Recommendation 4: Kyrgyz Agricultural Finance Corporation**

The Kyrgyz government should be encouraged to set a date to privatize KFC as soon as possible to end any banking market perception that the government is going to finance agriculture and the rural areas. KFC should be prepared for privatization, inviting local, regional, and international parties to find a strategic investor interested in developing the market that KFC has established



as its target market. Strategic investors should be committed to maintaining this target market as the central focus.

KFC is receiving technical assistance for its banking organization, lending and administrative operations from TACIS and perhaps these groups will continue even to assist in the development and implementation of a privatization plan. The World Bank and ADB funding of the KFC loan portfolio has been conditioned on the eventual privatization of KFC, but a definitive date and plan have not been developed. USAID should consider providing technical assistance for this activity.

It is not clear to the consultants if TACIS or World Bank are planning privatization prior to the termination of the technical assistance but this should occur to avoid KFC from becoming a government financing program. Clear government commitment should be obtained prior to developing terms of reference or task order.

Steps would include: 1) Development of a bank privatization plan and schedule, including the type of tender to interested investors; 2) Conducting a thorough audit and valuation in accordance with IAS; 3) Development of appropriate solicitation notices and information packages regarding privatization; 4) Allowance of serious bidders to examine the institution and portfolio; 5) Negotiation with potential bidders regarding each bidder's proposal on its interest in developing the Kyrgyz market and its commitment regarding investment, management, and advisory expertise; 6) Selection of bidder and closing of privatization transaction.

The value of KFC would be substantially higher if it had a banking license clearly operating under the Kyrgyz banking laws.

*Time Frame:*

Approximately 9 to 18 months depending upon the government's cooperation in facilitating the privatization. Cooperation is enhanced if the government agrees to a date certain for privatization and a general schedule for effecting that decision.

*Potential Implementer:*

Bearing Point has had substantial experience in bank privatization in Eastern Europe and former Soviet Union and could easily provide the professional technical assistance needed to accomplish the bank privatization through a slight modification of their current contract.

*Estimated Budget and Level of Effort:*

One qualified professional for a year with an estimated budget of \$350,000 to \$700,000 depending upon the available expertise and qualifications and time needed to accomplish.

### **Recommendation 5: Introduce USDA type mediation services**

USDA has an established program for providing mediation, the training of mediators, and trainers of trainers to develop a cadre of professionals to serve rural mediation needs. These services cover the complexities of USDA, EPA and other government policies, regulations, permits, licenses, and regulatory control, such as government agricultural loan programs, water user association disputes. For example, USDA mediators have successfully mediated very complex water management issues, such as mediation in Arizona where several parties were in dispute over water management including Indian nations; state, city, county, and town governments, federal and state water project authorities, major agricultural users, and industrial users of water.

### **Recommendation 6: Kyrgyz economic policy—Investors’ Secretariat**

A function of the Integrated Agribusiness Project czar should be to gather information on needed economic reforms from all project sources in the Osh Initiative and present them to the Investors’ Secretariat. The USAID representative or the Osh czar should be a member of the Secretariat to participate in the economic policy reform messages conveyed to the President.

#### *Rationale:*

Secretariat has mixed reviews regarding its effectiveness but more visibility granted to the Secretariat by a stronger USAID presence and participation may help this image.

Tasks would include collecting all USAID and other donor project reform information and transmitting the information to the Secretariat. This would demonstrate strong commitment by USAID to needed economic reforms to improve the Kyrgyz business climate. USAID would utilize this existing and valuable data to back up its reform arguments to the government and the Secretariat would provide a forum for these issues to be heard at the highest levels. It is recognized that actual reform adoption and implementation must occur from the Office of the President; however, this type of centralized information support from USAID and other donors provides a more comprehensive view on economic and business reforms.

#### *Budget and Level of Effort:*

No additional budget or level of effort aside from budget for the program czar.

### **B3c. Regional issues**

The consultants recommend that USAID consider the potential benefits of developing a Ferghana Valley approach that further integrates Kyrgyz (Osh), Uzbek (Ferghana), and Tajik (Khujand/Isfara) activities.

The EDP offices in Osh, Ferghana, and Khujand offer a unique opportunity to advocate enhanced regional trade. EDP has already implemented joint tri-country trade workshops focused on increased trade amongst the three countries. These initiatives should be enhanced with

participation with other donor projects to create desired synergies. The proposed Fergana Valley seal of quality is an example of the type of regional initiative that could facilitate regional trade and further market integration.

*Funding needed to reach program goals:*

Funding for this regional activity would be drawn primarily from existing EDP and TIP budgets; however, a review of existing budget allocations should be made in order to ensure that sufficient funding for this targeted activity is available. If funds are deemed insufficient then this line item should be increased in order to accommodate the proposed activities. Joint regional activities would be defined in the EDP and TIP work plans.



### **Kyrgyz Republic Country Profile**

**Source:** Library of Congress

#### **Population**

The population of Kyrgyzstan is divided among three main groups: the indigenous Kyrgyz, the Russians who remained after the end of the Soviet Union, and a large and concentrated Uzbek population. Topography divides the population into two main segments, the north and the south. Each has differing cultural and economic patterns and different predominant ethnic groups.

#### **Demographic Characteristics**

The censuses of 1979 and 1989 indicated annual population growth of a little over 2 percent, with a birth rate of 30.4 per 1,000 in 1989. The estimated birth rate in 1994 was twenty-six per 1,000, the death rate seven per 1,000, with a rate of natural increase of 1.9 percent. In 1993 average life expectancy was estimated at sixty-two years for males, seventy years for females--the second lowest rate among the former Soviet republics. In 1993 the infant mortality rate was estimated at 47.8 deaths per 1,000 live births. Early marriage and large family size have combined to make Kyrgyzstan's population a relatively young one. In 1989, some 39.5 percent of the population was below working age, and only 10.1 percent was of pension age. The 1989 census indicated that only about 38 percent of the country's population was urbanized.

#### **Ethnic Groups**

In 1993 the population of Kyrgyzstan was estimated at 4.46 million, of whom 56.5 percent were ethnic Kyrgyz, 18.8 percent were Russians, 12.9 percent were Uzbeks, 2.1 percent were Ukrainians, and 1.0 percent were Germans. The rest of the population was composed of about eighty other nationalities. Of some potential political significance are the Uygurs. That group numbers only about 36,000 in Kyrgyzstan, but about 185,000 live in neighboring Kazakstan. The Uygurs are also the majority population in the Xinjiang Uygur Autonomous Region of China, whose population is about 15 million, located to the northeast of Kyrgyzstan. In November 1992, the Uygurs in Kyrgyzstan attempted to form a party calling for establishment of an independent Uygurstan that also would include the Chinese-controlled Uygur territory. The Ministry of Justice denied the group legal registration.

Between 1989 and 1993, a significant number of non-Kyrgyz citizens left the republic, although no census was taken in the early 1990s to quantify the resulting balances among ethnic groups. A considerable portion of this exodus consisted of Germans repatriating to Germany, more than 8,000 of whom left in 1992 alone. According to reports, more than 30,000 Russians left the Bishkek area in the early 1990s, presumably for destinations outside Kyrgyzstan. In 1992 and 1993, refugees from the civil war in Tajikistan moved into southern Kyrgyzstan. In 1989 about 64,000 Kyrgyz were living in Tajikistan, and about 175,000 were living in Uzbekistan. Reliable estimates of how many of these people subsequently returned to Kyrgyzstan have not been available.

The Fergana Valley, which eastern Kyrgyzstan shares with Central Asian neighbors Uzbekistan and Tajikistan, is one of the most densely populated and agriculturally most heavily exploited regions in Central Asia. As such, it has been the point of bitter contention among the three adjoining states, both before and after the collapse of the Soviet Union. Members of the various ethnic groups who have inhabited the valley for centuries have managed to get along largely because they occupy slightly different economic niches. The sedentary Uzbeks and Tajiks traditionally have farmed lower-lying irrigated land while the nomadic Kyrgyz have herded in the mountains. However, the potential for ethnic conflict is ever present. Because the borders of the three countries zigzag without evident regard for the nationality of the people living in the valley, many residents harbor strong irredentist feelings, believing that they should more properly be citizens of a different country. Few Europeans live in the Fergana Valley, but about 552,000 Uzbeks, almost the entire population of that people in Kyrgyzstan, reside there in crowded proximity with about 1.2 million Kyrgyz.

### **Geographic Factors**

Population statistics depict only part of the demographic situation in Kyrgyzstan. Because of the country's mountainous terrain, population tends to be concentrated in relatively small areas in the north and south, each of which contains about two million people. About two-thirds of the total population live in the Fergana, Talas, and Chu valleys. As might be expected, imbalances in population distribution lead to extreme contrasts in how people live and work. In the north, the Chu Valley, site of Bishkek, the capital, is the major economic center, producing about 45 percent of the nation's gross national product. The Chu Valley also is where most of the country's Europeans live, mainly because of economic opportunities. The ancestors of today's Russian and German population began to move into the fertile valley to farm at the end of the nineteenth century. There was a subsequent influx of Russians during World War II, when industrial resources and personnel were moved en masse out of European Russia to prevent their capture by the invading Germans. In the era of Soviet First Secretary Leonid I. Brezhnev, a deliberate development policy brought another in-migration. Bishkek is slightly more than 50 percent Kyrgyz, and the rest of the valley retains approximately that ethnic ratio. In the mid-1990s, observers expected that balance to change quickly, however, as Europeans continued to move out while rural Kyrgyz moved in, settling in the numerous shantytowns springing up around Bishkek. The direct distance from Bishkek in the far north to Osh in the southwest is slightly more than 300 kilometers, but the mountain road connecting those cities requires a drive of more than ten hours in summer conditions; in winter the high mountain passes are often closed. In the Soviet period, most travel between north and south was by airplane, but fuel shortages that began after independence have greatly limited the number of flights, increasing a tendency toward separation of north and south.

The separation of the north and the south is clearly visible in the cultural mores of the two regions, although both are dominated by ethnic Kyrgyz. Society in the Fergana Valley is much more traditional than in the Chu Valley, and the practice of Islam is more pervasive. The people of the Chu Valley are closely integrated with Kazakhstan (Bishkek is but four hours by car from Almaty, the capital of Kazakhstan). The people of the south are more oriented, by location and by culture, to Uzbekistan, Iran, Afghanistan, and the other Muslim countries to the south. Geographical isolation also has meant that the northern and southern Kyrgyz have developed fairly distinct lifestyles. Those in the north tend to be nomadic herders; those in the south have

acquired more of the sedentary agricultural ways of their Uygur, Uzbek, and Tajik neighbors. Both groups came to accept Islam late, but practice in the north tends to be much less influenced by Islamic doctrine and reflects considerable influence from pre-Islamic animist beliefs. The southerners have a more solid basis of religious knowledge and practice. It is they who pushed for a greater religious element in the 1993 constitution.





## ANNEX B

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Extracts from :

*Growth in the Kyrgyz Republic Since the Mid-1990s: Sustainable Development or Agricultural Involution?*

A. R. Khan, 2002

Development in Kyrgyz Republic since independence can only be understood in the context of its historical development during the Soviet period. Soviet strategy was to create a specific pattern of agricultural specialization and industrial development in the Central Asian region to which Kyrgyz Republic belonged. Being a part of a highly autarkic economic union with the rest of the Soviet Union, with almost infinitely high common external tariff, would by itself have created a pattern of regional specialization that would have no necessary correspondence with the region's comparative advantage in the context of integration with the global economy.

The effect of integration with the rest of the Soviet Union was further modified and aggravated by a variety of instruments of central planning. In agriculture, the institutional framework for this planning was provided by the collectivized organization of agriculture in which rural households belonged either to state farms (sovkhoz) or to collective farms (kolkhoz). State farms, owned and managed directly by the state, paid the workers fixed wages, just as other state enterprises did, while the collective farms, in principle "owned" and managed by the members, paid them according to work points earned, the average value of work points being determined by the size of "distributed net income" relative to total work points earned by all workers. Each worker also had a tiny piece of private plot the produce of which was meant for their own consumption, but could also be sold to others.

The composition of output was influenced by a variety of instruments: procurement quotas which were obligatory for the collectives; procurement prices which were arbitrarily determined by the state; prices set by the state for inputs; the administratively-rationed quantities of inputs and services; and the overall infrastructure created by state investment. While quantitative controls over the composition of output were widely used, purchase and sale prices were used to influence relative profitability of crops and products in order to promote the desired pattern of specialization. As early as in the 1940s, when the Stalinist strategy of "primitive socialist accumulation" was extracting massive surplus from agriculture, Soviet policy in Central Asia was using favorable procurement price as the principal instrument to boost the production of cotton.

Soviet strategy used all these instruments to promote a particular kind of regional specialization in agriculture: wool, livestock products and, to a lesser extent, cotton in Kyrgyz Republic; cotton in Tajikistan, Uzbekistan and Turkmenistan; and wheat in Kazakhstan. Thus incentives were sharply shifted in favor of the respective crops and products in the republics named by the combined use of the instruments listed above.

Kyrgyz Republic became specialized in the production and export of wool, livestock products and, to a lesser extent, cotton. In spite of the well known problems under collective institutions and central planning, the country attained a certain degree of efficiency in the production of these

goods. In industries and services production was organized in large-scale state-owned enterprises. Soviet strategy of industrialization not only emphasized autarky at the union level, but also a degree of self sufficiency for the regions and republics. The manufacturing industries in Kyrgyz Republic thus had a relatively broad base: it included producers' goods like electrical engines and centrifugal pumps, a variety of farm machineries, even trucks; intermediate goods like cement and bricks; consumption goods like, textiles, garments, processed food; and agricultural processing like cotton fiber. Kyrgyz Republic was also a major producer of electrical energy and coal.

Apart from catering to domestic demand, much of these industries were based on the processing of material supplied by the rest of the Soviet Union or on demand for export to other Soviet republics. The pattern of specialization imposed by Soviet central planning was based on the planners' notion of the comparative advantage of the republics. It is quite possible that their presumption was often correct, that Kyrgyz Republic had comparative advantage in wool, livestock products, electrical energy, cement and coal. And yet the particular method of promoting specialization in the republic was flawed. The instruments that they used resulted in a serious distortion of incentives. In agriculture incentives were sharply tilted in favour of livestock products and cotton, and against grain. In industries, planning decisions were rarely based on rational economic calculations.

*Changes since independence: decline, recovery and structural change in agriculture*

Independence and the breakup of the Soviet Union inevitably disrupted this system of agricultural specialization. The elaborate system of subsidizing specific products could not be sustained. The rigid central planning of supplies of inputs and marketing of outputs broke down and caused additional disruption of production. The institution of collective agriculture was incapable of coping with these dislocations and their inefficiency was exacerbated by their inability to cope with the transition. Additional problems discussed in the preceding section in the context of overall economic decline – political instability, civil strife, the loss of subsidies from the Soviet Union, the inability to create new infrastructure to facilitate trade with new markets – aggravated these difficulties. The result was a decline in agricultural production during the first half of the 1990s.

As noted above, in Kyrgyz Republic the decline in agriculture was more modest than the decline in GDP during the first half of the decade and the real value added in agriculture was higher at the end of the decade than before independence. As expected, the transformation of agriculture did not affect all its components uniformly. Agriculture achieved substantial growth over the period as a whole; but the growth was limited to crop production including the production of food grains. Livestock products remained far lower at the end of the decade than at the beginning, resulting in the loss of exports of wool.

Despite a massive move towards free trade, there was a shift in favor of trade replacement, away from exports towards import substitution. There was a sharp increase in the output of wheat, indicating a shift of resources, including irrigated land, to this import-substitute crop. An exception to the pattern of decline in the output of agricultural export goods is cotton: while its

production fell in the major producing countries in Central Asia, in Kyrgyz Republic, a minor exporter of cotton, it actually increased.

These changes since independence could be explained with reference to three sets of factors: change in the system of incentives; change in the access to inputs and services; and change in agricultural institutions.

The three sets of factors often overlap. For example, changes in incentives affect input supply and changes in institutions influence incentives. Thus the discussion of these three factors entails a degree of overlap.

### *Changes in the system of incentives*

To what extent is the performance of agriculture related to changes in incentives for the sector? Does the change in the cropping pattern represent a correction of the extreme specialization that was fostered by the arbitrary Soviet policy in the past? One can only provide tentative answers to these questions in view of the lack of detailed information. Changes in the incentive system have been complex and are in need of a serious analysis for the formulation of future policies.

The breakup of the Soviet Union was followed by a gradual integration of Kyrgyz Republic with the global economy. It has radically reduced the average tariff rate and the extent of quantitative restrictions on trade. Domestically it has moved away from compulsory procurement, price control, distribution control and the restriction of private enterprise. It is, however, by no means clear that it has succeeded in creating a uniform and neutral system of incentives, free of significant distortions.

A decline in terms of trade represents a fall in the purchasing power of income generated in the sector. Thus the change in per capita agricultural output is too optimistic an indication of the change in real income of the workers and entrepreneurs in the sector.

The decline in agriculture's terms of trade have come about mainly due to the need of the state to overcome the severe fiscal difficulty caused by the withdrawal of Soviet subsidies and the general loss of revenue due to the economic downturn in the years following independence. Large agricultural subsidies were removed. Large transport costs have made the prices of imported fertilizer higher than average world price while they have prevented an equalization of domestic prices of agricultural products with world prices.

### *Access to inputs and services*

During the Soviet period, much of agriculture achieved a high intensity of input use. There was a serious decline in the quality and quantity of inputs available to agriculture after independence. In 1986-90, 252 kg of fertilizer was used per hectare of arable land.<sup>4</sup> By 1992, it had fallen to a tenth of the rate of use at the end of the 1980s! By the end of the 1990s there had been little recovery. The problem about access to inputs has been two fold: first, a steep rise in their price and second, a disruption in the supply channel. The problem of high price was sometimes exacerbated by the lack of coordination of price reform for inputs and outputs. The rise in the cost of machines, spare parts and fuel is widely perceived as obstacles to access to inputs.

Irrigation is another major agricultural input to which the quality of access has deteriorated. The maintenance of the irrigation infrastructure and the operation of the pumps have been under pressure due to the broader problem of management of water distribution. Access to traditional markets was disrupted due to the breakup of the former economic union.

Most importantly, Kyrgyz Republic lost its traditional export market for wool. The replacement of the traditional export market has been obviated, apart from the specific or low quality of the products, by the landlocked location of the country and the inability to finance the large investment needed to create new infrastructure.

The emergence of private farming, often organized by small individual and household farms, has created the need for the supply of a wide range of services in divisible units, of which the country has little experience. There is also an unmet need of small farmers for credit for the financing of their access to inputs and technology.

### *Problems of transformation from collective to private agriculture*

Post-independence Kyrgyz Republic was in need of an urgent and inevitable transformation of the organization of agriculture as of the economy as a whole. The collective institutions, the sovkhoz and the kolkhoz, were not relevant any more. Experience in many countries over many decades had shown that it was virtually impossible to have an efficient organization of work and incentives under these institutions. Political support for them had evaporated with the demise of socialist central planning.

The alternative was not, however, clear or obvious. Circumstances in Kyrgyz Republic were not the same as in the successful cases of decollectivization, notably China. In China collectivization of agriculture had lasted for approximately two decades, with plenty of experience of peasant farming surviving among the rural population. In Kyrgyz Republic collectivization had lasted for nearly six decades, erasing all experience of peasant farming from the contemporary generation of agricultural population. Furthermore, the resource endowment of agriculture in Kyrgyz Republic, with a relatively mechanized and irrigation-dependent farming, created a special problem of transition to decollectivization due to the indivisibility of technology and management that characterized socialist planning. Large tractors and combines could not be divided up among individual peasants and the centralized management of irrigation was in need of complex restructuring of organization commensurate with the change in the organization of farming. These factors constituted an obstacle to transition to a system of equitable private peasant farming.

Notwithstanding these problems Kyrgyz Republic has become an outstanding case of replacing collective agriculture by a system of egalitarian peasant farming through nearly universal access to land. In the decade beginning independence, Kyrgyz Republic distributed approximately 72 per cent of all agricultural land (except pasture) among nearly 2,596 thousand individuals (510 thousand families) in the form of land shares. This ensured that pretty much every household resident in rural areas ended up with land entitlement. Initially access to land was given in the form of lease for 49 years which was later extended to lease for 99 years. In the year 1998 the

national parliament conferred full ownership right on the peasants, including the right to sell land.

Simultaneously a moratorium on the particular provision about the right to sell was declared for five years which was recently rescinded. Starting September 1, 2001 land can be bought and sold with certain restrictions, notably that only Kyrgyz nationals with two years' residence in rural areas can buy land. The original distribution of land was reasonably equitable. Land was distributed according to the family size. There were large regional variations in the amount of land per person due to regional differences in the availability of distributable land per person.

Land distribution was not, however, accompanied by measures to promote access to complementary resources to enhance the ability of the weaker households to perform as farmers. This must emerge as an important issue in the future as the legalization of sale of land creates the possibility that more efficient farmers would buy up the land of the weak and inefficient farmers. The "Management of Land Act" of December 2000 provides for a legal limit on land concentration by making the maximum size of the agricultural land plot owned by any individual equal to "20 times the average land share established by a particular local state" with an absolute limit of 50 ha.<sup>5</sup> This limit appears too high to guarantee a system of egalitarian peasant farming. Other policies need to be geared to enhance the capability of the small peasants to remain viable and competitive.

Of the households that received land the highest proportion completely opted out of the collective system. A fair proportion of them, however, continued to be parts of cooperatives while others formed joint-stock companies. A number of state agricultural enterprises continue to operate, usually specializing in seed and livestock development.

The system was flexible enough to permit the independent peasant farmer to continue to receive certain services from the cooperative from which he/she has withdrawn. These cooperatives have no resemblance with the former collectives. They provide a minimum of services that are sufficiently indivisible to create an incentive on the part of the individual peasant households to combine in a cooperative arrangement for their provision.



## **ANNEX C: CONTACT LIST FOR KYRGYZSTAN**

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